Supreme Court, U.S.
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No. 96 -

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

EDWARD S. COHEN,

Petitioner,

v.

HILDA DE LA CRUZ; NELFO C. JIMENEZ; MARIA MORALES; GLORIA SANDOVAL; HECTOR SANTIAGO; SANTIA SANTOS; ELBA SARAVIA; ELVIA SIGUENZIA; ENILDA TIRADO,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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100 pp

QUESTION PRESENTED

Whether the sharply divided Third Circuit erred in holding, contrary to the decisions of the Ninth Circuit, the Bankruptcy Appellate Panel of the First Circuit, and numerous federal district and bankruptcy courts, that 11 U.S.C. § 523(a)(2)(A) prohibits the discharge in bankruptcy of punitive damages awarded on account of fraud.

PARTIES TO THE PROCEEDINGS

The parties to the proceedings in the United States Court of Appeals for the Third Circuit were petitioner Edward S. Cohen, defendant-appellant below, and respondents Hilda de la Cruz, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval, Hector Santiago, Santia Santos, Elba Saravia, Elvia Siguenzia, and Enilda Tirado, plaintiffs-appellees below.

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PETITION FOR A WRIT OF CERTIORARI

Edward S. Cohen respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The order of the United States Court of Appeals for the Third Circuit denying rehearing and denying the suggestion for rehearing *en banc* by an evenly divided court is unreported. It is reprinted in the appendix to the petition (App. 1a). The opinion of the divided panel of the Third Circuit is reported at 106 F.3d 52 (App. 2a-18a). The opinion of the District Court for the District of New Jersey is reported at 191 B.R. 599 (App. 19a-35a), and those of the Bankruptcy Court for the District of New Jersey are reported at 185 B.R. 171 (App. 36a-54a) and 185 B.R. 180 (App. 55a-71a).

JURISDICTION

The judgment of the United States Court of Appeals for the Third Circuit was entered on February 6, 1997. A timely petition for rehearing and suggestion of rehearing *en banc* was denied on March 5, 1997. Petitioner invokes the jurisdiction of this Court under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

The statutory provision at issue, 11 U.S.C. § 523, is reprinted in the appendix to this petition (App. 72a-78a).

STATEMENT OF THE CASE

This case presents an important and recurring question of bankruptcy law that has split the circuits and vexed the bankruptcy courts: whether 11 U.S.C. § 523(a)(2)(A) prohibits the discharge in bankruptcy of punitive damages awarded on claims of fraud. The courts below, while noting the conflicting authority, held that such damages are not dischargeable. A suggestion that the issue be reheard *en banc* was denied by an evenly divided court of appeals.

* * *

Petitioner Edward Cohen and his father owned and managed several apartment buildings in northeastern New Jersey during the late 1980s. Respondents were tenants in one such building in Hoboken. App. 3a. In 1989, the Hoboken Rent Control Administrator determined that the rents that the Cohens charged these tenants exceeded the limits imposed by the city's rent control ordinance, the Rent Leveling Act. *Id.* The Administrator ordered the Cohens to refund slightly more than $30,000 in rent overcharges. *Id.*

The Cohens' real estate enterprise subsequently failed, and they filed separate petitions seeking liquidation and discharge under Chapter 7 of the Bankruptcy Code. App. 3a. The tenants then brought an adversary proceeding against petitioner. *Id.* They sought treble damages for the rent overcharges under New Jersey's Consumer Fraud Act, N.J. Stat. Ann. §§ 56:8-2, 8-19, and a declaration that any recovery allowed to the tenants would be non-dischargeable under 11 U.S.C. § 523(a)(2)(A). *Id.*

The tenants prevailed on both claims. The bankruptcy court found that petitioner committed "actual fraud," within the meaning of § 523(a)(2)(A), by failing to disclose to the tenants that their rents violated the Rent Leveling Act ordinance. App. 4a, 70a. The court also concluded that petitioner's conduct, although not willful but merely reckless, was "unconscionable" under the Consumer Fraud Act, N.J. Stat. Ann. § 56:8-2. App. 4a, 50a. The court imposed compensatory damages of slightly more than $30,000, the amount by which the actual rents exceeded the allowable rents. App. 54a. In addition, the court trebled the compensatory damages award, as required by the Consumer Fraud Act, for a total judgment of more than $90,000. *Id.*

The court further held that § 523(a)(2)(A) — which denies debtors a discharge of "any debt . . . for money . . . to the extent obtained by . . . fraud" — precluded discharge of the punitive, as

well as the compensatory, portion of the damages award.[1] App. 4a, 53a. After noting the conflicting authority on the question, the court concluded that the term "debt," as used in § 523 and the rest of the Bankruptcy Code, is broad enough to include both the compensatory and punitive portions of a damages award. App. 52a-53a. The court further observed that before § 523(a)(2)(A) was adopted in its current form in 1984, all damages, compensatory or punitive, arising from a single course of conduct were treated as either dischargeable or non-dischargeable. The court found no indication that Congress intended to alter that rule when it adopted the current § 523(a)(2)(A). App. 52a-53a. The district court affirmed for similar reasons. App. 33a-35a.

Petitioner, proceeding *pro se*, appealed to the Third Circuit, where a divided panel affirmed. First, the majority held that the text of § 523(a)(2)(A), in barring discharge of "debts . . . for money . . . to the extent obtained by . . . fraud," does "not clearly limit nondischargeable damages under § 523(a)(2)(A) to compensatory damages only." App. 10a.[2] In particular, the majority declined to construe this language to "requir[e] distinguishing between the theories of recovery under which the debt is owed" (*id.*) — that is, whether the debt is owed to compensate the victim of the fraud or to punish the debtor who committed the fraud.

Second, after deeming the statutory text to be "at best unclear" on the dischargeability question, the majority turned to the legislative history of § 523(a)(2)(A). App. 10a. The majority noted that the exceptions to dischargeability had traditionally been

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[1] The court made no finding that petitioner was a fiduciary of the tenants or that he had inflicted any willful and malicious injury. Thus, § 523(a)(4) and § 523(a)(6), which respectively bar discharge of debts for fiduciary fraud and willful and malicious injury, do not apply here.

[2] The majority and dissent treated the trebled portion of the damages award as purely punitive. *See* App. 6a n.2. New Jersey courts agree. *See Pierzga v. Ohio Casualty Group*, 504 A.2d 1200, 1203 (N.J. Ct. App. 1986).

"broadly construed to cover both punitive and compensatory portions of debt for culpable conduct." App. 11a-12a. Nothing in the legislative history of the 1984 amendments to the Bankruptcy Code — which included the current version of § 523(a)(2)(A) — persuaded the majority that Congress had intended to depart from that rule. App. 12a.

Finally, the majority held that denying discharge of all damages awards for fraud, whether compensatory or punitive, served public policy by allowing a "fresh start" only to the "honest but unfortunate debtor." App. 13a (quoting *Grogan v. Garner*, 498 U.S. 279, 286-87 (1991)). "Where a debtor has committed fraud under the code," said the majority, "he is not entitled to the benefit of a policy of liberal construction against creditors." *Id.*

In dissent, Judge Greenberg would have adopted the view of "'[m]ost courts,'" which "'have held that punitive damages awards are dischargeable under § 523(a)(2).'" App. 16a (quoting *In re Auricchio*, 196 B.R. 279, 290 (Bankr. D.N.J. 1996)). As he construed the statute, in providing for non-dischargeability of debts for money "to the extent obtained by . . . fraud," § 523(a)(2)(A) mandates a distinction between the compensatory and punitive portions of damages awards in fraud cases. In contrast to compensatory damages, he explained, "punitive damages do not reflect money, property, or services the debtor 'obtained.'" App. 14a-15a.

Judge Greenberg contrasted the "to the extent" language of § 523(a)(2)(A) with the language of two other provisions of § 523: § 523(a)(4), which bars the discharge of "any debt for fraud" by a fiduciary, and § 523(a)(6), which bars the discharge of "any debt for willful and malicious injury." These provisions have been construed to deny a discharge for punitive as well as compensatory damages. If Congress had intended to deny discharge of all damages, compensatory and punitive, awarded in fraud cases, he reasoned, Congress would have used the same sort of language in § 523(a)(2)(A) as it used in § 523(a)(4) and § 523(a)(6). App. 15a.

Judge Greenberg concluded by disagreeing with the majority's concern that wrongdoers would go unpunished if punitive damages were dischargeable under § 523(a)(2)(A), noting the ease with which plaintiffs recover punitive damages for fraud even when, as here, the debtor's "conduct [is] hardly shocking." App. 17a.

Petitioner's *pro se* petition for rehearing and suggestion of rehearing *en banc* was denied. App. 1a. Six of the Third Circuit's twelve active judges would have granted rehearing *en banc*. *Id.*

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW IS INCONSISTENT WITH SECTION 523'S PLAIN LANGUAGE AND STRUCTURE

Section 523(a) of the Bankruptcy Code makes a number of categories of debts ineligible for discharge in personal bankruptcy. Section 523(a)(2)(A), the provision at issue here, states that "[a] discharge [under the Code] does not discharge an individual debtor from any debt . . . for money . . . to the extent obtained by . . . fraud." Until 1992, the courts had almost "uniformly held that punitive damages are not nondischargeable under this provision," *In re Stokes*, 150 B.R. 388, 391 (W.D. Tex. 1992), *aff'd on other grounds*, 995 F.2d 76 (5th Cir. 1993) — a rule that, as the dissent noted below, continues to be applied by "'[m]ost courts'" today. App. 16a (quoting *In re Auricchio*, 196 B.R. at 290); *see also In re Levy*, 951 F.2d 196, 199 (9th Cir. 1991) (holding punitive damages dischargeable under § 523(a)(2)(A)), *cert. denied*, 504 U.S. 985 (1992); *In re Bozzano*, 173 B.R. 990, 998 (Bankr. M.D.N.C. 1994) (describing this as the "majority and better reasoned rule"). The leading bankruptcy treatise, while noting the conflicting appellate and trial court authority on the issue, has likewise taken the position that § 523(a)(2)(A)'s bar against discharge "should not apply to

punitive damages." 4 COLLIER ON BANKRUPTCY ¶ 523.08[4], at 523-53 (15th ed. (Rel. 60 12/96) 1996).[3]

The conclusion of the panel majority in this case is contrary not only to this weight of authority but also to the plain language and evident purpose of § 523(a)(2)(A). *See United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989) (When "the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'") (quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917)). The majority failed to recognize that punitive damages — damages in excess of the debtor's gain or the victim's loss as a result of the fraud — are not "obtained," in any sense of that term, by the debtor.

The plain meaning of "obtained" is "[t]o come into the possession or enjoyment of (something) by one's own effort, or by request; to procure or gain, as the result of purpose and effort; hence, generally to acquire, get." X OXFORD ENGLISH DICTIONARY 669 (2d ed. 1989); *see also* THE RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE 995 (unabridged ed. 1966) (defining "obtain" as "to come into possession of; get or acquire; procure, as through an effort or by a request"). Hence, compensatory damages, such as the refund of the excess rents that petitioner obtained from respondents in this case, constitute a "debt . . . for money . . . obtained by . . . fraud." They represent money that "c[a]me into the possession" of the debtor "by [his] own effort, or by request," that the debtor "procur[ed] or gain[ed], as the result of purpose and effort."

Punitive damages awarded on account of fraud do not, however, represent money "obtained" by the debtor. As the Ninth Circuit has explained, punitive damages "do not represent losses to the victim of fraud or increases in the wealth of the debtor who engages in fraud; rather, such damages are 'awarded

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[3] The Collier treatise very recently concluded that this is the more appropriate construction of § 523(a)(2)(A). An earlier version of the treatise, cited by the majority below (App. 8a), took the contrary view that punitive damages were *not* dischargeable under that provision.

as an example to others or as a penalty or by way of punishment.'" *In re Levy*, 951 F.2d at 198 (quoting *In re McDonald*, 73 B.R. 877, 882 (Bankr. N.D. Tex. 1987)); *cf. O'Gilvie v. United States*, 117 S. Ct. 452, 455 (1996) ("punitive damages are . . . not designed to compensate . . . victims") (internal quotations omitted). Thus, because the debtor never "obtains" — *i.e.*, comes into possession of — the money reflected in a punitive damages award, decisions such as the one below "fail[ ] to take into account the plain meaning of [§ 523(a)(2)(A)]." Constance C. Vaughn, Comment, *The Dischargeability Debate: Are Punitive Damages Dischargeable Under 11 U.S.C. § 523(a)(2)(A)?*, 10 BANKR. DEV. J. 423, 435 n.83 (1994). In other words, although the punitive damages "may have been caused by the Debtor's fraudulent behavior," "no reasonable construction of statutory terms would equate 'cause' with 'obtain.'" *In re Sciscoe*, 164 B.R. 86, 89 (S.D. Ind. 1993); *see also* 4 COLLIER ON BANKRUPTCY ¶ 523.08[4], at 523-53 (punitive damages are dischargeable under § 523(a)(2)(A) because they are "assessed in addition to the compensatory damages that are measured by the amount of property obtained by the fraudulent conduct or the actual harm suffered by the creditor").

The text of two other provisions of § 523(a) — which is strikingly different from the text of § 523(a)(2)(A) — further undermines the reasoning of the panel below. Sections 523(a)(4) and (a)(6) provide, respectively, that a debtor may not be discharged from "any debt for fraud or defalcation while acting in a fiduciary capacity" or "any debt for willful and malicious injury." Neither of these provisions employs the "to the extent obtained" language of § 523(a)(2)(A). As Judge Kozinski noted in *In re Bugna*, 33 F.3d 1054 (9th Cir. 1994), § 523(a)(4) and § 523(a)(6) are thus "clearly distinguishable" from § 523(a)(2)(A): "Because punitive damages are not *obtained* by fraud but rather imposed because of it, they are not restitutionary as required under section 523(a)(2). Section 523(a)(4), like section 523(a)(6), conspicuously lacks this limiting language." *Id.* at 1059 (citation omitted). Not surprisingly, most courts, including those like the Ninth Circuit that have construed

§ 523(a)(2)(A) as allowing the discharge of punitive damages, hold that punitive damages are not dischargeable under § 523(a)(4) and § 523(a)(6).[4]

It must be presumed that Congress had a reason for using different language in § 523(a)(2)(A) than in § 523(a)(4) and § 523(a)(6). *See Brown v. Gardner*, 513 U.S. 115, 120 (1994) ("'where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposefully in the disparate inclusion or exclusion'") (quoting *Russello v. United States*, 464 U.S. 16, 23 (1983)). As Judge Greenberg argued in dissent below, "if punitive damages are not to be dischargeable, there is no need for the 'money, property, services . . . to the extent obtained' provision in section 523(a)(2)(A)." App. 15a. Instead, Congress could, and presumably would, simply have denied discharge for any "debt for fraud," as it did in § 523(a)(4) with respect to those acting in a fiduciary capacity. *Id.* The majority's reasoning erroneously ignores the differences in the statutory language, thereby "construl[ing] a statute so as to render portions of it [*i.e.*, the "to the extent obtained" clause of § 523(a)(2)(A)] superfluous." *Id.*

The construction of § 523(a)(2)(A) adopted by the majority below also renders superfluous a substantial portion of § 523(a)(4). If Congress in § 523(a)(2)(A) sought to bar discharge of punitive damages in all fraud cases, then why would Congress in § 523(a)(4) have barred discharge of punitive damages in fraud cases against fiduciaries? The more reasonable explanation is that Congress sought to prevent the discharge of punitive damages only in particularly egregious cases, such as

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[4] *See, e.g., Printy v. Dean Witter Reynolds, Inc.*, 110 F.3d 853, 859 (1st Cir. 1997) (§ 523(a)(6)); *In re McNallen*, 62 F.3d 619, 625-26 (4th Cir. 1995) (§ 523(a)(6)); *In re Bugna*, 33 F.3d at 1058-59 (§ 523(a)(4)); *In re Britton*, 950 F.2d 602, 605 (9th Cir. 1991) (§ 523(a)(6)); *In re Miera*, 926 F.2d 741, 745 (8th Cir. 1991) (§ 523(a)(6)); *In re Wallace*, 840 F.2d 762, 765-66 (10th Cir. 1988) (§ 523(a)(4)).

where the fraud was committed by an individual in a position of trust and confidence (§ 523(a)(4)) or where the fraud was "willful and malicious" (§ 523(a)(6)). *Cf. Grogan v. Garner*, 498 U.S. at 282 n.2 (suggesting, without deciding, that "arguably, fraud judgments . . . that include punitive damage awards are more appropriately governed by § 523(a)(6)" than by § 523(a)(2)(A)).[5]

Such a construction of § 523(a)(2)(A) is, contrary to the conclusion of the majority below (App. 13a), fully consistent with federal bankruptcy policy. It is a "well-established interpretational rule that exceptions from discharge are to be strictly construed so as to give maximum effect to the policy of the bankruptcy code to provide debtors with a 'fresh start.'" *In re Geiger*, No. 95-3913, 1997 U.S. App. LEXIS 11235, at *16 (8th Cir. May 14, 1997) (en banc). Because § 523(a)(2)(A) "conflict[s] with the fresh start policy of the Bankruptcy Code" by creating an exception to dischargeability, courts have recognized that the provision "should be read no more broadly than required" to implement the competing policy "against debtors avoiding fraud-based debts in bankruptcy." *In re Suter*, 59 B.R. 944, 947 (Bankr. N.D. Ill. 1986). These policies are appropriately balanced by denying a discharge only for the

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[5] While resort to the legislative history is unnecessary given the plain language of § 523(a)(2)(A) and related provisions of § 523, the legislative history is consistent with the construction of the provision urged by petitioner. Prior to 1984, § 523(a)(2)(A) barred discharge of a "debt for obtaining money by fraud," which courts construed to bar discharge of both compensatory and punitive damages in fraud cases. *See* App. 11a-12a. But Congress amended the statute in 1984 to bar discharge only for money, property, or services "to the extent obtained by . . . fraud." There is no legislative history explaining Congress' purposes for this change. It is appropriate to presume, however, that Congress did not rewrite existing law for no reason. *See Brown v. Gardner*, 513 U.S. at 120. The most plausible reason is that Congress sought to discharge the punitive damages liability of debtors whose fraud neither was "willful and malicious" nor was committed in a fiduciary capacity.

debtor's gain or the victim's loss from the fraud, as well as for any punitive damages awarded for fraud that was "willful and malicious" or committed by a fiduciary. To construe § 523(a)(2)(A) so broadly as to bar the discharge of all punitive damages awards would, indeed, violate the policy that "there is no punishment for punishment's sake in bankruptcy." *In re Alwan Bros.*, 105 B.R. 886, 892 (C.D. Ill. 1989).

II. THE DECISION BELOW CONFLICTS WITH OTHER APPELLATE, DISTRICT, AND BANKRUPTCY COURT DECISIONS HOLDING THAT PUNITIVE DAMAGES ARE DISCHARGEABLE UNDER § 523(a)(2)(A)

It has been widely recognized that "[c]ourts are divided on the question of whether punitive damages awarded in fraud cases are nondischargeable" under § 523(a)(2)(A). *In re Spicer*, 57 F.3d 1152, 1160 (D.C. Cir. 1995), *cert. denied*, 116 S. Ct. 701 (1996). A majority of the courts have concluded that § 523(a)(2)(A) does not prohibit the discharge of punitive damages. *In re Bozzano*, 173 B.R. at 997-98 (case involving statutory treble damages of the sort at issue here; collecting authorities). The Ninth Circuit adopted that rule in *In re Levy*, 951 F.2d 196, and reaffirmed it in *In re Bugna*, 33 F.3d 1054. Recently, the Bankruptcy Appellate Panel of the First Circuit, observing that the "courts that have addressed the issue . . . are split," expressly adopted the position of both the Ninth Circuit and the dissent in this case. *In re Markarian*, BAP No. MW 96-031, 1997 Bankr. LEXIS 644, at *9, *11-*12 (1st Cir. BAP May 13, 1997).[6] The court agreed that the phrase "to the extent

[6] Under 28 U.S.C. § 158(b), appellate panels, composed of three bankruptcy judges, may be created to review decisions of bankruptcy courts in each circuit. The panels exist "to provide a uniform and consistent body of bankruptcy law throughout the entire Circuit." *In re Windmill Farms*, 70 B.R. 618, 622 (9th Cir. BAP 1987), *rev'd on other grounds*, 841 F.2d 1467 (9th Cir. 1988). "In order to achieve this desired uniformity, the decisions of the Bankruptcy Appellate Panel must

obtained by . . . fraud" in § 523(a)(2)(A) "is meant to limit the nondischargeable debt to the amount actually obtained by fraud"; because punitive damages "are awarded as a penalty or punishment or as an example to others," said the court, "[t]hey are not a debt for fraud and should not be excepted from discharge under section 523(a)(2)(A)." *Id.* at *12.

Two circuits now squarely disagree. The Eleventh Circuit in *In re St. Laurent*, 991 F.2d 672, 677 (11th Cir. 1993), acknowledged that "[b]ankruptcy courts are divided on this issue," and that "[m]ost adhere to the view that [punitive damage] awards are dischargeable under § 523(a)(2)(A)." The court rejected that majority view, however, holding that a "debt," within the meaning of § 523(a)(2)(A), "encompasses an award for punitive damages arising from the same conduct as necessitated an award of compensatory damages." *Id.* at 680. In so holding, the Eleventh Circuit recognized that its decision created a direct conflict with the Ninth Circuit's decision in *In re Levy*. *See* 991 F.2d at 679. The Third Circuit in this case likewise recognized the division of authority on the dischargeability of punitive damages under § 523(a)(2)(A), noting that "[a] number of courts, including two courts of appeals, have interpreted this provision and have come to conflicting conclusions about its meaning." App. 7a; *see also* App. 16a-17a (Greenberg, J., dissenting) (noting conflict). The majority ultimately deemed the Eleventh Circuit's position in *St. Laurent* to be "more persuasive," and "therefore [held] that debts caused by fraud under § 523(a)(2)(A) are nondischargeable in their entirety." App. 8a.

The division over whether § 523(a)(2)(A) allows the discharge of punitive damages awards in fraud cases is just as dramatic in the district and bankruptcy courts. Section 523(a)(2)(A) has been construed to permit discharge of punitive damages awards by

be binding on all of the bankruptcy courts from which review may be sought, i.e., each district in the . . . Circuit." *Id.*

courts in the Fourth,[7] Fifth,[8] and Eighth Circuits.[9] Meanwhile, courts in the Second,[10] Sixth,[11] and District of Columbia[12] Circuits have taken the contrary position. Courts in the Seventh[13] and Tenth[14] Circuits have gone both ways on the issue. Indeed, in the Seventh Circuit, the conflict extends even to bankruptcy courts within the same district. In *In re Suter*, 59 B.R. at 947, Judge Ginsberg held that § 523(a)(2)(A) does not bar the discharge of punitive damages because "[i]t is not possible under any rational reading of the English language that [a punitive damage award] in any way represents a 'debt for money . . . to the extent obtained by . . . actual fraud.'" In *In re Pawlinksi*, 170 B.R. 380, 391-92 (Bankr. N.D. Ill. 1994), however, Judge Schmetterer refused to follow *Suter*, apparently concluding that § 523(a)(2)(A) was susceptible of a different "rational reading."

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[7] *In re Owen*, 181 B.R. 288, 290 (Bankr. W.D. Va. 1995); *In re Bozzano*, 173 B.R. at 997-98; *In re Freeman*, 142 B.R. 758, 762 (Bankr. E.D. Va. 1991).

[8] *In re Stokes*, 150 B.R. at 391; *In re McDonald*, 73 B.R. at 882.

[9] *In re Brady*, 154 B.R. 82, 85 (Bankr. W.D. Mo. 1993).

[10] *In re George*, 205 B.R. 679, 682 (Bankr. D. Conn. 1997); *In re Tobman*, 96 B.R. 429, 439-40 (Bankr. S.D.N.Y.), *rev'd on other grounds*, 107 B.R. 20 (S.D.N.Y. 1989).

[11] *In re Winters*, 159 B.R. 789, 790 (Bankr. E.D. Ky. 1993).

[12] *In re Spicer*, 155 B.R. 795, 801 (Bankr. D.D.C. 1993), *aff'd on other grounds*, 57 F.3d 1152 (D.C. Cir. 1995), *cert. denied*, 116 S. Ct. 701 (1996).

[13] *Compare, e.g., In re Sciscoe*, 164 B.R. at 89 (dischargeable) *and In re Alwan Bros*, 105 B.R. at 891-92 (same) *with In re Pawlinski*, 170 B.R. 380, 391-93 (N.D. Ill. 1994) (non-dischargeable).

[14] *Compare In re Thrall*, 196 B.R. 959, 967 (Bankr. D. Colo. 1996) (dischargable) *and In re Brown*, 66 B.R. 13, 16 (Bankr. D. Utah 1986) (dischargeable) *with In re Bolzle*, 158 B.R. 853, 856 (Bankr. N.D. Okla. 1993) (non-dischargeable).

Judge Barliant subsequently rejected *Pawlinski* and endorsed *Suter*, adopting "the majority view that the express language of the statute limits the non-dischargeable debt to only that amount actually obtained by the fraud and not to punitive damages imposed because of the fraud." *In re Van Quach*, 187 B.R. 615, 621-22 (Bankr. N.D. Ill. 1995).[15]

This ever-widening split in the lower federal courts clearly demonstrates that the question presented by this case is recurring and important. "Given the persisting controversy regarding the propriety and constitutionality of the skyrocketing awards of punitive damages, it is not unexpected that the issue of the dischargeability of such awards has divided the courts as well." *In re Alwan Bros.*, 105 B.R. at 888. Many courts have addressed the issue, often in several cases, since the amendment of § 523(a)(2)(A) in 1984. As a consequence, a debtor's treatment under the national bankruptcy laws may depend entirely on geographic happenstance, notwithstanding the Constitution's command that there be "uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. art. I, § 8, cl. 4.

Nor is there any significant prospect that this conflict will be resolved without this Court's intervention. Although the bankruptcy courts have frequently considered the dischargeability of punitive damages under § 523(a)(2)(A), the courts of appeals have only rarely had the opportunity to address the issue,

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[15] The academic commentators have also reached conflicting conclusions on this issue. *Compare* Janet Malloy Link, Note, *When a Sting is Overkill: An Argument for the Discharge of Punitive Damages in Bankruptcy*, 94 Colum. L. Rev. 2724 (1994) *and* Constance C. Vaughan, Comment, *The Dischargeability Debate: Are Punitive Damages Dischargeable Under 11 U.S.C. § 523(a)(2)(A)?*, 10 Bankr. Dev. J. 423 (1994) (both embracing dischargeability) *with* Nina Lempert, Note, *Punitive Damages — The Dischargeability Debate Continues*, 11 Bankr. Dev. J. 707 (1995) *and* Lee Blake, Casenote, *St. Laurent v. Ambrose: No Haven for the Fraudulent Debtor*, 26 Ariz. St. L.J. 561 (1993) (both rejecting dischargeability).

presumably because parties to a personal bankruptcy proceeding often cannot afford the expense and delay associated with an appeal. A petition for certiorari on this issue is even rarer. To our knowledge, the issue has not been presented to this Court since the circuits first divided four years ago. It appears that this debate can be resolved only by a decision of this Court: the Ninth Circuit has recently reaffirmed its ruling in favor of dischargeability, *see In re Bugna*, 33 F.3d 1054; and the Third Circuit in this case refused to reconsider the panel's contrary decision *en banc*.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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Dated: June 3, 1997

APPENDIX

[Filed March 5, 1997]

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 96-5155

IN RE: EDWARD S. COHEN, Debtor

EDWARD S. COHEN, Appellant

SUR PETITION FOR REHEARING

Present: SLOVITER, Chief Judge,
BECKER, STAPLETON, MANSMANN,
GREENBERG, SCIRICA, COWEN, NYGAARD,
ALITO, ROTH, LEWIS, and MCKEE,
Circuit Judges and HILLMAN, District Judge.*

The petition for rehearing filed by appellant in the above entitled case having been submitted to the judges who participated in the decision of this court and to all other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied. Judges Becker, Stapleton, Greenberg, Scirica, Alito and Roth would have granted rehearing.

BY THE COURT
/s/ Carol Los Mansmann
Circuit Judge

*District Judge Hillman, U.S. District Judge for the Western District of Michigan, who sat by designation on the original panel, voted only as to panel rehearing.

UNITED STATES COURT OF APPEAL
THIRD CIRCUIT

In re Edward S. COHEN, Debtor,
Edward S. COHEN, Appellant,

v.

Hilda DE LA CRUZ; Nelfo C. Jimenez; Maria Morales; Gloria Sandoval; Hector Santiago; Santia Santos; Elba Saravia; Elvia Siguenzia; Enilda Tirado.

No. 96-5155.
Feb. 6, 1997.

Before: MANSMANN and GREENBERG, Circuit Judges, and HILLMAN, District Judge*

OPINION OF THE COURT

HILLMAN, District Judge.

Edward S. Cohen appeals from the order of the New Jersey District Court affirming the bankruptcy judge's determination that certain debts were nondischargeable in bankruptcy because they were obtained by fraud, as defined in 11 U.S.C. § 523(a)(2)(A). Because we conclude that section 523(a)(2)(A) excludes punitive as well as compensatory damages from discharge, we will affirm.

I.

In 1985, appellant, Edward Cohen ("Cohen"), and his father, Nathan Cohen, purchased an 18-unit residential apartment building at 600 Monroe Street in Hoboken, New Jersey. They held title to the Monroe Street property until December 1989. The Cohens also owned several other residential properties: another multi-family apartment building in Hoboken, one in

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* Honorable Douglas W. Hillman of the United States District Court for the Western District of Michigan, sitting by designation.

Union City, two in Paterson, one in Jersey City and one in Newark.

The Hoboken Rent Leveling Act (The Act) is a comprehensive rent control ordinance which governed the Monroe Street property. The rents set by the Cohens were approximately double what they could legally charge under the Act. Most of the tenants in the Monroe Street units were non-native speakers of English with little education.

In 1989, the Hoboken Rent Control Administrator determined that the Cohens had violated the Act. The Cohens were ordered to refund amounts totaling $31,382.50. The amounts were not refunded and the Cohens failed to perfect an appeal from the determination of the Administrator. Thereafter, the Cohens filed for Chapter 7 bankruptcy, seeking to discharge these as well as other debts.

On February 14, 1991, the tenants filed an adversary proceeding against Edward Cohen in the bankruptcy court. They claimed that the debts owed to them were procured by fraud and were thus nondischargeable in bankruptcy under 11 U.S.C. § 523(a)(2)(A). Additionally, each tenant sought a judgment for three times the amount of the refund pursuant to New Jersey's Consumer Fraud Act, N.J. Stat. Ann. §§ 56:8-1 to 8-9.

At trial, the plaintiffs testified that they had no knowledge of the legal amount of rent. Most were unaware that any rent control ordinance governed the property. Cohen admitted that at the time he purchased the property, he was aware that the rent control ordinance existed. He claimed, however, that he never inquired about the requirements of the ordinance nor was he advised of its provisions. He testified that he was aware that he could not raise rents more than 6% per annum, but claimed to believe that he could charge new tenants any amount up to fair market value. In fact, the Act limited the amount of rent the Cohens could charge existing and new tenants.

After hearing the testimony, the bankruptcy judge determined that the debts were nondischargeable and that the Consumer Fraud

Act applied. The court found that Cohen, despite being represented by counsel, recklessly made no effort to investigate the statute and selectively inquired about its application. The court further found that Cohen conveniently understood that the ordinance allowed him to surcharge his tenants for increases in water bills and taxes and he knew where he could apply for such relief. Cohen claimed, however, that he did not think to investigate how much he could charge new tenants. Based on these facts, the bankruptcy court found that Cohen had selectively understood and applied the provisions of the ordinance that were to his benefit, but wilfully failed to ascertain the less advantageous provisions. On the basis of Cohen's admittedly selective understanding of the statute, the bankruptcy court concluded that he had committed fraud within the meaning of the bankruptcy code. The court also held that Cohen's conduct violated the New Jersey Consumer Fraud Act, N.J. Stat. Ann. 56:8-1, and that Cohen was statutorily liable for treble damages. The bankruptcy court held that the treble damage award also was nondischargeable in bankruptcy, and it entered a total judgment for $94,147.50. The district court affirmed. *In re Cohen,* 191 B.R. 599 (D.N.J. 1996).[1]

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[1] The district court had jurisdiction to hear this case pursuant to 28 U.S.C. § 158(a). Because the bankruptcy court first heard this case, Bankruptcy Rule 8013 governed the district court's standard of review:

> On an appeal the district court or bankruptcy appellate panel may affirm, modify, or reverse a bankruptcy judge's judgment, order or decree or remand with instructions for further proceedings. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of witnesses.

Our jurisdiction rests on 28 U.S.C. § 1291 and 28 U.S.C. § 158(d). 8013. We exercise plenary review over the district court's order, because a district court sits as an appellate court in bankruptcy court.

In his appeal, Cohen contends that the district court erred in affirming the order of the bankruptcy court. First, he asserts that, in finding that appellant's conduct amounted to nondischargeable fraud under 11 U.S.C. § 523(a)(2)(A), the bankruptcy court and the district court applied incorrect principles of law and made clearly erroneous factual findings. Second, he argues that, even if his conduct amounted to fraud under the bankruptcy code, it did not constitute a violation of the New Jersey Consumer Fraud Act, N.J. Stat. Ann. § 56:8-1. Third, he contends that the treble damage provision of the New Jersey Consumer Fraud Act is a punitive damage award. As such, Cohen contends that the treble damage portion of the debt is dischargeable under 11 U.S.C. § 523(a)(2)(A).

We have carefully considered both the facts and the law and we find no error in the district court's conclusion that Cohen committed fraud within the meaning of 11 U.S.C. § 523(a)(2)(A) and N.J. Stat. Ann § 56:8-1. Both the bankruptcy court and the district court applied the correct principles of law, and the factual findings of the bankruptcy court were not clearly erroneous. Because Cohen's objections to the bankruptcy court's findings of fraud raise no substantial questions not fully addressed by the courts below, we affirm without discussion the district court's order affirming the bankruptcy judge's findings of fraud under both the bankruptcy code and the New Jersey Consumer Fraud Act.

In re Cohn, 54 F.3d 1108, 1113 (3d Cir. 1995). We review the bankruptcy court's findings of fact for clear error. *Id.* We exercise plenary review over questions of law. *Id.*

However, because the question of whether punitive damages[2] are dischargeable under 11 U.S.C. § 523(a)(2)(A) is the subject of a split in the circuits, we will address that issue in full.

II.

Section 523(a) of the federal bankruptcy statute provides limited exceptions to the general dischargeability of debts of eligible claimants under the statute. Specifically, section 523(a) sets forth sixteen types of debts that are nondischargeable under the code. The subsection at issue here— 523(a)(2)(A)—originally excepted from discharge any debt "for obtaining money, property [or] services . . . by . . . actual fraud. . . ." Federal courts interpreted this provision to include punitive as well as compensatory damages within the exception to discharge. *See, e.g., In re Maxwell,* 51 B.R. 244, 246 (Bankr. S.D. Ind. 1983); *In re Carpenter,* 17 B.R. 563, 564 (Bankr. E.D. Tenn. 1982). Cf. *Birmingham Trust Nat. Bank v. Case,* 755 F.2d 1474, 1477 (11th Cir. 1985).

Congress amended this provision in 1984, thereby giving rise to the issue we now address. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub.L.No. 98-353, 1984 U.S.C.C.A.N. (98 Stat.) 333, 376. We must determine whether punitive damages are nondischargeable under the second of these exceptions, which provides in relevant part:

> (a) A discharge under . . . this title does not discharge an individual debtor from any debt—
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> • • • • •

[2] We assume without deciding for purposes of this opinion that the treble damages provision of N.J. Stat. Ann. § 56:8-9 is purely punitive and does not serve a compensatory function. *But see Cox v. Sears Roebuck & Co.*, 138 N.J. 2, 24, 647 A.2d 454, 465 (N.J. 1994) (suggesting that purpose of treble damage and attorney fee awards was partly compensatory).

> (2) for money, property, services, or an extension, renewal or refinancing of credit, *to the extent obtained by*—
>
> (A) false pretenses, a false representation, or actual fraud. . . .

11 U.S.C. § 523(a)(2)(A) (emphasis added).

A number of courts, including two courts of appeals, have interpreted this provision and have come to conflicting conclusions about its meaning. Several courts, including the Court of Appeals, for the Ninth Circuit, have held that, by including the phrase "to the extent obtained by" in the exception, Congress intended to limit the exception strictly to compensatory damages for the actual amount caused by the fraud. Consequently, those courts have held that punitive damages for fraud are dischargeable, notwithstanding § 523(a)(2)(A). *See, e.g., In re Levy,* 951 F.2d 196 (9th Cir. 1991), (the language of the statute suggests that the subsection limits nondischargeability to the amount of benefit to the debtor or loss to the creditor the act of fraud itself created); *In re Auricchio,* 196 B.R. 279, 289-90 (Bankr. D.N.J. 1996); *In re Bozzano,* 173 B.R. 990, 998 (Bankr. M.D.N.C. 1994); *In re Suter,* 59 B.R. 944, 947 (Bankr. N.D. Ill. 1986).

Other courts, however, including the Eleventh Circuit, have concluded that the language of the statute is ambiguous and that, because Congress' intent in adding the language is not clear, all damages resulting from fraud, whether punitive or compensatory, are nondischargeable under § 523(a)(2)(A). *See, e.g., In re St. Laurent,* 991 F.2d 672, 677-81 (11th Cir. 1993); *In re Roberti,* 201 B.R. 614, 622-23 (Bankr. D.Conn. 1996); *In re Winters,* 159 B.R. 789, 790 (Bankr. E.D. Ky. 1993); *In re Manley,* 135 B.R. 137, 144-45 (Bankr. N.D.Okla. 1992). *See also 3 Collier on Bankruptcy,* ¶ 523.08 at 523-52 n. 27 (15th ed. 1996) ("The phrase 'to the extent obtained by . . . actual fraud,' which was added to section 523 in 1984, should not be read to limit a finding of nondischargeability only to the compensatory aspects of a fraud judgment."). *Cf. In re Gerlach,* 897 F.2d 1048, 1051 n. 2 (10th Cir. 1990) (holding that, with respect to a fraudulently

obtained extension of credit, the language "to the extent obtained by" had not altered the amount of debt made nondischargeable under§ 523(a)(2)(A)). *See also 3 Collier on Bankruptcy*. ¶ 523.08 at 523-52 n. 27 (15th ed. 1996) (The phrase "to the extent obtained by . . . actual fraud," which was added to section 523 in 1984, should not be read to limit a finding of nondischargeability only to the compensatory aspect of a fraud judgment.).

We find the careful analysis of the Eleventh Circuit to be more persuasive than that of the Ninth Circuit. We conclude that the language "to the extent obtained by" was not intended by Congress to limit the amount of debt considered nondischargeable under § 523(a)(2)(A). We therefore hold that debts caused by fraud under § 523(a)(2)(A) are nondischargeable in their entirety.

A. The Plain Meaning of the Statute

Liability under state law for damages caused by fraud, whether punitive or compensatory, clearly represents a debt within the meaning of the bankruptcy code. *In re Bugna*, 33 F.3d 1054, 1058 (9th Cir. 1994); *In re St. Laurent*, 991 F.2d at 678. Under the Code, a "debt" is defined as "liability on a claim." 11 U.S.C. § 101(12). A "claim" is further defined as a "right to payment, whether or not such right is reduced to judgment . . . ." 11 U.S.C. § 101(5)(A). *See In re St. Laurent*, 991 F.2d at 678. "A 'right to payment' is 'nothing more nor less than an enforceable obligation, regardless of the objectives . . . to [be] serve[d] in imposing the obligation.'" *Id.* (quoting *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 559, 110 S.Ct. 2126, 2131, 109 L.Ed.2d 588 (1990)).

Despite the broad sweep of this definition of "debt," courts have held that punitive damages resulting from fraud as defined by § 523(a)(2)(A) are nevertheless dischargeable because, by including in § 523(a)(2)(A) the language "to the extent obtained by," Congress intended "to limit the nondischargeable debt to the amount 'obtained by actual fraud.'" *In re Levy*, 951 F.2d at 198 (quoting *In re Ellwanger*, 105 B.R. 551, 555 (B.A.P. 9th Cir. 1989)). In *In re Levy*, the Ninth Circuit reasoned that, because

punitive damages "do not represent losses to the victim of fraud or increases in the wealth of the debtor who engages in fraud," they " 'are not a debt for fraud.'" *Id.* (quoting *In re McDonald*, 73 B.R. 877, 882 (Bankr. N.D. Tex. 1987)).

At the heart of the Ninth Circuit's analysis is an assumption that the words "to the extent obtained by" modify the word "debt." We disagree with such a reading of the statute.

First, the word "debt" appears in the general section preceding all sixteen specific exceptions to dischargeability. In contrast, the words "to the extent obtained by" follow most directly after a listing of other nouns: "money, property, services, or an extension, renewal, or refinance of credit." It is most sensible and most in accord with general linguistic analysis to apply a modifying phrase to the nearest objects, in this case "money, property, services, or an extension, renewal, or refinance of credit."

In addition, it strains the structure of the statute as a whole to conclude that the definition of the word "debt," which applies to all sixteen exceptions to dischargeability and elsewhere in the bankruptcy code, is altered by language contained in the second of these exceptions, and that the meaning of the word "debt" is different only with respect to that single exception. Indeed, one of the basic canons of statutory construction is that identical terms within an Act bear the same meaning. "Thus, Congress' expansive definition of 'debt' applies to each subsection of § 523(a), absent clear intent to the contrary." *In re St. Laurent*, 991 F.2d at 680 (citations omitted).

We conclude that Congress intended the language "to the extent obtained by" to modify not "debt," but "money, property, services, and extension . . . of credit." This conclusion is reinforced when one analyzes the provision with specific attention to the items in the list other than "money"—i.e., "property," "services" or "extension of credit." It may at first blush appear plausible that Congress intended to limit some damage portion of the nondischargeable debt when one asks whether the debt in issue is a "debt . . . for money, . . . to the extent obtained by the

fraud." However, when one asks whether the debt is a "debt . . . for refinancing of credit, . . . to the extent obtained by the fraud," it is apparent that the meaning of "to the extent obtained by the fraud" is to distinguish between fraudulently and legally refinanced credit, not to limit the objectives being "serve[d] in imposing the obligation." *Davenport*, 495 U.S. at 559, 110 S.Ct. at 2131. *See In re Manley*, 135 B.R. at 145. So understood, the language appears not to distinguish actual from punitive damages, but "contractual debts tainted with fraud from debts for mere breach of contract or 'failure to pay.'" *In re Manley*, 135 B.R. at 145.

In the instant case, Cohen obtained substantial sums in rent from plaintiffs, only $31,382.50 of which was obtained by fraud. As a result, the amount of Cohen's debt for this fraudulently-obtained sum is nondischargeable. The dissent agrees with our analysis that "to the extent obtained by" modifies "money" not "debt." It suggests, however, that the amount in excess of $31,382.50 awarded as treble damages was not obtained by fraud and therefore is not within the exception. However, the statutory language specifically states that the "*debt for* . . . money . . . to the extent obtained by . . . fraud" is not dischargeable. One's debt for fraudulently obtained monies may and frequently does exceed the actual sum of the fraud. For example, the debt normally includes interest, costs of recovery and attorney fees, as well as compensatory and punitive damages. Under New Jersey law, one's debt for such fraudulently obtained monies includes three times the amount of the fraudulently obtained sum. Nothing in the language "to the extent obtained by" requires distinguishing between the theories of recovery under which the debt is owed.

We therefore conclude that the language on its face does not clearly limit nondischargeable damages under § 523(a)(2)(A) to compensatory damages only.

B. Legislative History

Where, as here, statutory meaning is at best unclear, we look to the legislative history to resolve any conflict. *See Patterson v. Shumate*, 504 U.S. 753, 761, 112 S. Ct. 2242, 2248, 119 L. Ed. 2d 519 (1992) (stating that resort to statutory history is appropriate where language of statute is ambiguous or confusing). "The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Kelly v. Robinson*, 479 U.S. 36, 47, 107 S.Ct. 353, 359, 93 L.Ed.2d 216 (1986). In particular, the Supreme Court has observed that a court should "not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Davenport*, 495 U.S. at 563, 110 S.Ct. at 2133.

As the Tenth Circuit previously has observed about the 1984 amendments,

> there is no reason to conclude that the 1984 amendments were anything but technical and cosmetic. We have found no legislative history reflecting that Congress intended to significantly alter the rights and obligations of creditors and debtors governed by this section. . . .

In re Gerlach, 897 F.2d 1048, 1051 n. 2 (10th Cir. 1990) (holding that "to the extent obtained by" was not intended to limit the amount of nondischargeable credit extensions). *See also In re St. Laurent, 991 F.2d at 680.*

Prior to the 1984 bankruptcy amendments, the statute provided that a debtor was not entitled to a discharge of "any debt . . . for obtaining money, property, services, or an extension, renewal, or refinance of credit, by . . . false pretenses, a false representation, or actual fraud. . . ." The language change in 1984 merely struck "obtaining" preceding "money," and added "to the extent obtained" at the end of the list of things which may be obtained by fraud. In this historical context, the language seems a simple (though arguably less clear) rewording of the earlier phrasing.

Nothing in the 1978 version of the statute suggests that punitive damages for fraud should be distinguished from the compensatory portion of such debt. Instead, under the 1978 phrasing, subsection (2) of section 523(a) should be interpreted consistently with the other exceptions, which have been broadly

construed to cover both punitive and compensatory portions of debt for culpable conduct, even by those courts that have rejected such a broad interpretation of the modified § 523(a)(2)(A). *See, e.g., In re Bugna*, 33 F.3d 1054, 1058-59 (9th Cir. 1994) (punitive damages nondischargeable under § 523(a)(4)); *In re Britton*, 950 F.2d 602, 606 (9th Cir. 1991) (punitive damages nondischargeable under § 523(a)(6)). In fact, prior to the 1984 amendments, courts had held that punitive damages as well as compensatory damages for fraud were nondischargeable under § 523(a)(2). *See, e.g., In re Maxwell*, 51 B.R. 244, 246 (Bankr. S.D. Ind. 1983) ("Punitive damages awarded pursuant to state law for actions which would render a debt nondischargeable, see 11 U.S.C.A. § 523(a)(2), (4), and (6), are nondischargeable in bankruptcy."); *In re Carpenter*, 17 B.R. 563, 564 (Bankr. E.D. Tenn. 1982) (both compensatory and punitive damages nondischargeable under § 523(a)(2)). *Cf. Birmingham Trust Nat. Bank v. Case*, 755 F.2d 1474, 1477 (11th Cir. 1985) ("[T]he plain language of the statute suggests that dischargeability is an 'all or nothing' proposition.").

The Supreme Court's dicta in *Grogan v. Garner*, 498 U.S. 279, 282 n. 2, 111 S.Ct. 654, 657 n.2, 112 L.Ed.2d 755 (1991), is not to the contrary. In *Grogan*, the Court specifically declined to address the question presently before us: "whether § 523(a)(2)(A) excepts from discharge that part of a judgment in excess of the actual value of money or property received by a debtor by virtue of fraud." *Id.* While the Court recognized that such a proposition was "arguable," it expressly avoided deciding the issue. The Court's mere acknowledgment of an arguable position not only is dicta, but also does not suggest any future direction of the Court. As a practical matter, the *Grogan* Court actually reinstated a district court's decision that a state court judgment for fraud, including punitive and compensatory damages, was nondischargeable under § 523(a)(2)(A).

We therefore conclude from the legislative history that Congress intended with § 523(a)(2)(A) to create an exception for a type of debt caused by limited, culpable conduct. Congress did not intend, however, that the amount of such debt or claim,

including the theories of recovery for such conduct, was to be limited by the section.

C. Policy Considerations

Sound policy also supports our decision. First, in the absence of the fraud that gave rise to the nondischargeable, compensatory portion of the debt, there would be no liability for punitive damages. "To discharge an ancillary debt which would not exist but for a nondischargeable debt seems erroneous." *In re Roberti*, 201 B.R. at 623 (quoting *In re Weinstein*, 173 B.R. 258, 273-75 (Bankr. E.D.N.Y. 1994)) (internal quotations omitted).

Second, our result is consistent with the "fresh start" policy of the bankruptcy code. As the Supreme Court has stated, "the opportunity for a completely unencumbered new beginning [is limited]" to the "honest but unfortunate debtor." *Grogan*, 498 U.S. at 286-87, 111 S.Ct. at 659-60. Where a debtor has committed fraud under the code, he is not entitled to the benefit of a policy of liberal construction against creditors. *Id.*; *Birmingham Trust*, 755 F.2d at 1477. *Cf. In re Braen*, 900 F.2d 621, 625 (3d Cir. 1990) ("Although it is true that the bankruptcy laws were generally intended to give troubled debtors a chance, the nondischargeability exceptions reflect Congress' belief that debtors do not merit a fresh start to the extent that their debts fall within § 523."), *cert. denied*, 498 U.S. 1066, 111 S.Ct. 782, 112 L.Ed.2d 845 (1991). We think it unlikely that Congress, in excepting fraud from dischargeability, "would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud." *Grogan*, 498 U.S. at 287, 111 S.Ct. at 659.

Furthermore, the amount of actual damages in consumer fraud cases, although significant to the plaintiffs, is often not large. Without including treble damages in the nondischargeable debt, victims of fraud will have even greater difficulty obtaining competent legal representation to pursue adversarial actions in bankruptcy court and prevent fraudulent debtors from using the Bankruptcy Code to evade lawful state judgments.

Finally, we observe that our decision is consistent with the punitive damages at issue in this case. Under New Jersey law, treble damages are statutorily mandated for every violation of the Consumer Fraud Act. *See Cox v. Sears, Roebuck & Co.*, 138 N.J. 2, 647 A.2d 454, 465 (1994). As a result, the debtor is fully aware at the time of his commission of a fraud of the full amount of the "debt" he will owe on a determination that he has committed such fraud. In this practical, additional sense, treble damages should be nondischargeable as an indistinguishable component of the debt owed.

III.

For the above reasons, we conclude that punitive damages are nondischargeable under 11 U.S.C. § 523(a)(2)(A). Accordingly, the district court's decision affirming the judgment of the bankruptcy court will be affirmed.

GREENBERG, Circuit Judge, dissenting.

Judge Hillman obviously has written a thoughtful opinion. Nevertheless, I respectfully dissent insofar as the majority holds that the damages to the extent trebled are not dischargeable. In this opinion I will treat the trebled portion of the damages as punitive damages in accordance with the majority opinion.

11 U.S.C. § 523(a)(2)(A) provides that a discharge "does not discharge an individual debtor from any debt for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by false pretenses, [or] a false representation. . . ." The initial issue on this appeal is thus whether "to the extent obtained" relates to "debt" or to "money, property, [or] services." The majority holds that "to the extent obtained" refers to "money, property, [or] services" and I agree. After all, it would be awkward to think that the debtor "obtained" a "debt," for what the debtor obtains is something of value, thus creating a debt.

But at that point I part company with the majority because treating "to the extent obtained" as referring to "money, property, [or] services," makes it clear to me that punitive

damages are dischargeable, for the punitive damages do not reflect money, property, or services the debtor "obtained." Punitive damages are simply a penalty and are something a debtor pays rather than obtains. Here, Cohen "obtained" only the overcharges which are reflected in the compensatory damages which we all agree are not dischargeable.

Furthermore, if Congress intended that punitive damages under section 523(a)(2)(A) were to be non-dischargeable, as the majority holds, it seems to me that the statute simply would read that "A discharge . . . does not discharge an individual debtor from any debt for false pretenses, [or] a false representation. . . ." That formulation would be consistent with treating punitive damages as part of the debtor's "debt." In other words, if punitive damages are not to be dischargeable, there is no need for the "money, property, services . . . to the extent obtained" provision in section 523(a)(2)(A). I believe that we should not construe a statute so as to render portions of it superfluous.

Congress used the structure that I suggest would support the majority's result in 11 U.S.C. § 523(a)(4) which recites that "A discharge . . . does not discharge an individual debtor from any debt for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." Thus, in a section 523(a)(4) case the exception to the discharge is not confined by a provision equivalent to the "money, property, services . . . to the extent obtained" provision in section 523(a)(2). There is a structure similar to section 523(a)(4) in 11 U.S.C. § 523(a)(6) which provides that "A discharge . . . does not discharge an individual debtor from any debt for willful and malicious injury by the debtor to another entity or to the property of another entity." It therefore follows that fiduciaries in the enumerated cases, embezzlers, thieves and persons who commit willful and malicious torts cannot obtain discharges of punitive damage awards.

Congress thus carefully distinguished the types of wrongdoing when it set forth the exceptions to a discharge. I, like the majority, would honor that distinction by holding that "to the

extent obtained" in section 523(a)(2) relates to "money, property [or] services" and not to "debt," but would go further and hold that the punitive damages simply are not "money, property, [or] services" as those three terms relate to something the debtor obtained. Thus, punitive damages are dischargeable in cases coming within section 523(a)(2). I point out that while I have reached my result through my own analysis, it is hardly innovative as I merely am taking the position taken by most other courts. *See In re Auricchio*, 196 B.R. 279, 290 (Bankr. D.N.J. 1996). ("Most courts have found that punitive damages awards are dischargeable under § 523(a)(2).") (collecting cases).

There is court of appeals support for my position for, as the majority points out, the Court of Appeals for the Ninth Circuit has reached a result opposite to that the majority reaches today. *See In re Levy*, 951 F.2d 196 (9th Cir. 1991), *cert. denied*, 504 U.S. 985, 112 S.Ct. 2965, 119 L.Ed.2d 586 (1992); *see also In re Bugna*, 33 F.3d 1054, 1058-59 (9th Cir. 1994). That court in *Bugna* explained the law as follows:

> This plain reading of section 523(a)(4) is consistent with our interpretation of other subsections within section 523(a). We have interpreted section 523(a)(6), which contains language similar to that in section 523(a)(4), as barring discharge of punitive damages liability. *See In re Britton*, 950 F.2d 602, 606 (9th Cir. 1991); *In re Adams*, 761 F.2d 1422, 1427-28 (9th Cir. 1985). And, though we have said that section 523(a)(2) does not bar discharge of punitive damages, *In re Levy*, 951 F.2d 196, 199 (9th Cir. 1991), that section is clearly distinguishable: '[U]nlike sections 523(a)(4) and 523(a)(6), [section 523(a)(2)] does not bar discharge of punitive damages.' *Id.* at 198. Congress specifically limited the application of section 523(a)(2) to 'debt . . . to the extent obtained by false pretenses, a false representation, or actual fraud.' 11 U.S.C. § 523(a)(2)(A) (emphasis added). Because punitive damages are not obtained by fraud but rather imposed because of it, they are not restitutionary as required under section 523(a)(2). *Levy*, 951 F.2d at 199. Section 523(a)(4), like section 523(a)(6), conspicuously lacks this limiting language.

Bugna, 33 F.3d at 1058-59. The majority criticizes the analysis in *Levy* because *Levy* presumes "that the words 'to the extent obtained by' modify the word 'debt'." Majority at 56. While I agree that "to the extent obtained by" does not modify "debt," still it seems clear to me that the Court of the Appeals for the Ninth Circuit correctly distinguished between section 523(a)(2) on the one hand and sections 523(a)(4) and (a)(6) on the other.

I believe my proposed result is consistent with the fresh start policy of the Bankruptcy Code. While the majority expresses concern that a debtor acting fraudulently will escape the consequences of his or her action, I think it is important to understand how broadly fraud has come to be defined. *See* N.J. Stat. Ann. § 56:8-2 (West 1989) (definition of conduct wrongful under the Consumer Fraud Act). Consider fraud under RICO. As every federal judge knows, in RICO civil cases plaintiffs frequently allege mail fraud as the racketeering activity in situations in which no United States Attorney would seek a RICO indictment. *See* 18 U.S.C. § 1961(1)(B). In RICO cases, just as under the New Jersey Consumer Fraud Act, treble damages are recoverable. 18 U.S.C. § 1964(c). This case will come to be authority that the trebled portion of the damages in a civil RICO case are not dischargeable, even though the dispute leading to the judgment is essentially commercial, and the racketeering activity is mail fraud.

Indeed, in this case, while I have not dissented from the finding that Cohen committed fraud, his conduct was hardly shocking. The district court described Cohen's conduct as follows: "[Cohen] made an implicit representation regarding the rent he charged—his silence coupled with the rental amount fixed constituted a representation that he was charging lawful rent." *In re Cohen*, 191 B.R. 599, 605 (D.N.J. 1996). Furthermore, the finding of fraud was not predicated on Cohen's actual knowledge. Rather, as the district court explained, it was based on his reckless disregard of the truth.

I recognize that Cohen's situation is not one that can generate much sympathy. He was, after all, a landlord dealing with persons whose primary language was Spanish and who had little education. *Id.* at 602. Nevertheless, if "an implicit representation" can give rise to a non- dischargeable punitive damages judgment, in some cases poor or uneducated people may feel the thrust of our opinion as such persons may make "implicit representation[s]" just as Cohen did. The majority's opinion may come to haunt such people seeking to make a fresh start.

UNITED STATES DISTRICT COURT,
D. NEW JERSEY.

In re Edward S. COHEN, Debtor,

Hilda DE LA CRUZ; Nelfo C. Jimenez; Maria Morales; Gloria Sandoval; Hector Santiago; Santia Santos; Elba Saravia; Elvia Siguenzia; Enilda Tirado, Plaintiffs-Appellees,

v.

Edward S. COHEN, Defendant-Appellant.

Civ. No. 95-4958 (WHW).
Feb. 7, 1996.

OPINION

WALLS, District Judge.

Debtor Edward S. Cohen brings this appeal from a final judgement of the bankruptcy court in which plaintiffs were awarded punitive and compensatory damages of $94,147.50.

BASIS OF APPELLATE JURISDICTION

28 U.S.C. § 157 confers upon bankruptcy courts the power to hear and determine all court proceedings arising under Title 11, arising in or related to a case under Title 11, and all core proceedings under Title 11. 28 U.S.C. § 158(a) confers jurisdiction on district courts to hear appeals from final judgments of bankruptcy courts in cases and proceedings under 28 U.S.C. § 157.

This appeal arises from a final judgment of the Honorable Rosemary Gambardella, United States Bankruptcy Judge for the District of New Jersey, in which she awarded compensatory and punitive damages against the debtor after determining the debt to

be "non-dischargeable" under 11 U.S.C. § 523(a)(2)(A). Accordingly, this Court has jurisdiction.

UNCONTESTED FINDINGS OF FACT BY THE BANKRUPTCY COURT

The debtor and his father, Nathan Cohen, owned, managed and operated real estate housing from October 1984 until the end of 1990. Their first purchase was a multiple dwelling building at 502 Jefferson Street, Hoboken, New Jersey. See Transcript of November 12, 1993 trial (Trans.) at 47. In August 1985 they purchased another multiple dwelling property at 600 Monroe Street in Hoboken. Trans. at 44. And thereafter, they purchased more real estate: 711 Palisades Avenue, Union City; 34-40 Plum Street, Paterson; 210 South Street, Jersey City, 14 Beech Street, Paterson. Trans. 48-50, 64.

Because he could no longer cover the expenses of his properties, on November 21, 1990, the Debtor filed a chapter 7 petition with the United States Bankruptcy Court in the District of New Jersey. Trans. at 50.

In the period before he filed for bankruptcy the debtor operated the Monroe property and rented the 18 apartments within. Sandy, his superintendent, managed the property and was responsible for renting the apartments. Trans. at 18. This property, for the duration of the debtor's ownership, was regulated by a Hoboken Rent Control ordinance which limited the amount of, and increase in, rent that could be charged. See Hoboken Code § 155 et seq. The debtor was notified by the Rent Leveling and Stabilization Board (the "Board") in September of 1989 that he was charging some of his tenants rents in excess of that allowed by the ordinance. Trans. at 56-57. Those tenants who were overcharged and identified by the Board to the debtor are the plaintiffs: Hilda De La Cruz, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval, Hector Santiago, Santia Santos, Elba Saravia, Elvia Siguenzia, and Enilda Tirado.

All of the plaintiffs were born in South America, spoke Spanish as their primary, if not only, language, and, except for

Ms. Tirado, who completed high school, none had received an education beyond grade level six. Trans. at 19- 30. The parties stipulated the amount of overpayment charged to each plaintiff—the total amount was $31,382.50.[1]

The debtor was aware of the existence of the rent control ordinance at the time he purchased the property. Based on discussions had with other landlords, he believed that he was permitted to charge the fair market value for each apartment but could only increase the rent of existing tenants by six percent. Trans. at 51-52. He was not aware that the rent control ordinance set limits on the amount of rent that could be charged for a vacant apartment. Trans. at 53. He had had no formal or informal discussions or inquiries with the local Rent Leveling Board concerning the effect of the rent control ordinance on the rent he could charge. Trans. at 53. Furthermore, even though he was represented by an attorney at the time he purchased the subject property, he never consulted with that, or any other attorney about the rent control ordinance. Trans. at 53-54, 72-73. He also never read, nor obtained a copy of the ordinance. Trans. at 72-73. At trial the parties stipulated that the debtor had made no claims to the plaintiffs that the rents he had set conformed to the rent leveling ordinance, and that, at the time the apartments were rented, there were no discussions about rent control between the plaintiffs and him. Trans. at 7.

While he had never sought to learn from the Rent Control Board the amount of rent he could set, the debtor did inquire about surcharging his tenants for the increases in taxes and water charges imposed by the City of Hoboken in 1986 and again in 1988. Trans. at 70. He was informed that he could surcharge for these amounts, and did so. Trans. at 70-72.

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[1] The individual amounts of overpayment are: Nelfo C. Jiminez—$5,681.50; Elvia Siguenzia $3,319.00; Hilda De La Cruz—$5,048.00; Maria Morales—$5,310.00; Hector Santiago—$5,975.00; Santia Santos—$728.00; Gloria Sandoval—$5,321.00; Enilda Tirado—$0.00.

After he received notice of the Board's decision that he had overcharged the plaintiffs, he failed to perfect his appeal. Trans. at 79. Yet he did not reimburse any of the plaintiffs. *Id.*

PROCEDURAL HISTORY

Plaintiff tenants filed an adversary proceeding against the debtor on February 11, 1991. The complaint sought a declaration that debts owed by the debtor to the plaintiffs were non-dischargeable under 11 U.S.C. § 523(a), damages equal to the amount of overpayment of rent, treble damages, and reasonable attorneys fees pursuant to the New Jersey Consumer Fraud Act, N.J.S.A. 56:8- 1 et seq.

On November 12, 1993, the bankruptcy court conducted a trial of the issue of whether the debt was dischargeable under 11 U.S.C. § 523(a). On October 24, 1994, the court by opinion declared the debt non-dischargeable. *In re Cohen*, 185 B.R. 171, 172 (Bankr. D.N.J. 1994) (the "First Opinion"). Thereafter the court received briefs from the parties and conducted a damages hearing. The amount of rent overcharge was not disputed—rather the parties disagreed over the applicability of the New Jersey Consumer Fraud Act (the "Act") providing for the imposition of treble damages. In an opinion of June 19, 1995, the court held that the Act applied, that the debtor had violated it and that he was therefore liable for punitive and compensatory damages. *In re Cohen*, 185 B.R. 180, 183 (Bankr. D.N.J. 1995) (the "Second Opinion").

The debtor now brings this appeal to this Court, and seeks reversal on the following grounds: 1) that the debt in question is dischargeable; 2) that the New Jersey Consumer Fraud Act does not apply to the dispute; 3) that fraud had not been established under the Act; and 4) that the punitive damages imposed are not excepted from discharge under 11 U.S.C. § 523(a)(2)(A).

STANDARD OF REVIEW

Bankruptcy Rule 8013 provides that a bankruptcy judge's findings of fact "shall not be set aside unless clearly erroneous."

Conclusions of law, however, are subject to de novo review. *See Universal Minerals, Inc. v. C.A. Hughes and Co.*, 669 F.2d 98, 102 (3d Cir. 1981).

It is not always clear, though, whether a matter of dispute is factual or legal. The Third Circuit, in *Universal Minerals, Inc. v. C.A. Hughes & Co.*, 669 F.2d 98, 102 (3d Cir. 1981), has defined the criteria courts should use to determine whether to apply the clearly erroneous or the de novo standard of review.[2] It noted that the beginning place of inquiry involves the status to be accorded each determination by the trial court, and whether that determination involves basic facts, inferred facts or ultimate facts. *Id.* at 102. Basic facts are the "historical and narrative events elicited from the evidence presented at trial, admitted by stipulation, or not denied, where required, in responsive pleadings." *Id.* Inferred facts are "drawn" from the basic facts and may be found "only when, and to the extent that, logic and human experience indicate a probability that certain consequences can and do follow from the basic facts." Id. Both basic and inferred factual determinations involve no legal conclusions and thus should be disturbed only when clearly erroneous. *Id.*

An ultimate fact, however, "is usually expressed in the language of a standard enunciated by case-law rule or by statute, e.g., an actor's conduct was negligent; the injury occurred in the course of employment; the rate is reasonable; the company has

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[2] In *Universal Minerals* the Court's discussion of the different kinds of facts and the applicable standard of review was general and thus has relevance in many different contexts. The Universal Minerals conclusions are particularly appropriate here, though, for both cases concern appeals from bankruptcy courts. Debtor argues, however, that *Universal Minerals* is not relevant to the present case because it established a standard of review for the court of appeals rather than for the district courts. This claim is spurious. The court wrote in Universal Minerals, "[w]e are in as good a position as the district court to review the findings of the bankruptcy court, so we review the bankruptcy court's finding by the standards the district court should employ . . ." 669 F.2d at 102.

refused to bargain collectively. 'The ultimate finding is a conclusion of law or at least a determination of a mixed question of law and fact.'" *Id.* (quoting R. Aldisert, The Judicial Process 694 (1976)).

Consequently, this Court shall apply the appropriate standard of review to each finding of the Bankruptcy Court based upon whether it involves a basic, inferred or ultimate fact.

DISCUSSION

I. The Dischargeability of the Debt

11 U.S.C. Section 523(a)(2)(A) provides:

(a) A discharge under section 727, 1141, 1228(a), 1228(b) or 1328(b) of this title does not discharge an individual debtor from any debt—

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement representing the debtor's or other insider's financial condition . . .[3]

In order to prevail under this section the creditor must show: "(1) the debtor obtained money, property or services through a material misrepresentation; (2) the debtor, at the time, knew the representation was false or made with gross recklessness as to its truth; (3) the debtor intended to deceive the creditor; (4) the creditor reasonably relied on the debtor's false representations; and (5) the creditor sustained a loss and damages as a proximate result of the debtor's materially false representations." *In re Poskanzer*, 143 B.R. 991, 999 (Bankr. D.N.J. 1992). In the proceedings below Bankruptcy Judge Gambardella found that

[3] A plaintiff-creditor seeking the benefit this provision must prove its elements by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991).

plaintiffs had established all of the above elements thereby rendering the debt non-dischargeable.

Debtor argues that the bankruptcy court erred because the first three elements were not proved. Specifically, he made no material misrepresentation—indeed he made no affirmative representation at all—and thus there could be no accompanying finding of intent or reckless indifference to the falsity of that representation. Not surprisingly, plaintiffs counter that all elements were established. They argue further that the bankruptcy court's determination that the debtor made a misrepresentation and that he acted with reckless indifference to the truth of that representation are findings of fact that must be upheld unless clearly erroneous. Debtor argues that they constitute legal conclusions and this Court's review must be plenary. The Court finds that these are classic "ultimate fact" determinations which, under *Universal Minerals*, 669 F.2d at 102, require de novo review.

The Debtor's position is that because he made no affirmative representation to the plaintiffs, he can not be deemed to have made a misrepresentation. Plaintiffs contend, and the Court below found, that when the debtor set the rents for the plaintiffs he impliedly represented that those amounts were lawful. Because they were greater than that permitted under the rent control ordinance, the debtor committed a misrepresentation. The Court finds plaintiffs' argument persuasive. Debtor made an implicit representation regarding the rent he charged—his silence coupled with the rental amount fixed constituted a representation that he was charging lawful rent.

Debtor also asserts that because he was unaware that that representation was false he could not have made a misrepresentation. However, there is no knowledge requirement within the first element of § 523(a)(2)(A)—that he may not have understood that he had made a misrepresentation is simply not germane. He materially misrepresented the amount he could and did charge plaintiffs.

The second and third elements that must be satisfied to render a debt non-dischargeable because of fraud are knowledge of the falsity of the representation and an intent to deceive on the part of the debtor, respectively. *In re Poskanzer*, 143 B.R. at 999. Bankruptcy courts have generally followed the principle that actual knowledge as well as intent to deceive may be established by a showing that the debtor recklessly disregarded the truth. *See, e.g., In re Woolley*, 145 B.R. 830, 834 (Bankr. E.D. Va. 1991). Recently, in *In re Cohn*, 54 F.3d 1108, 1118-19 (3d Cir. 1995), the Third Circuit discussed what a plaintiff must evidence to prove both knowledge and intent to deceive by a debtor under § 523(a)(2)(B), which provides that debts incurred based on a false written statement are non-dischargeable. The Court "acknowledge[d] that because a debtor will rarely, if ever, admit that deception was his purpose, [this element] is extremely difficult for a creditor to prove by direct evidence." *Id.* at 1118. It determined, in accord with several other circuits, "that the intent to deceive can be inferred from the totality of the circumstances, including the debtor's reckless disregard for the truth." *Id.* at 1118-19. While *In re Cohn* addressed § 523(a)(2)(B) rather that § 523(a)(2)(A), the Court's rationale of how scienter and intent may be proved under the former is fully applicable to the latter. Not only are the contexts closely related, but the difficulty of proving subjective intent of a debtor is the same. On the basis of *In re Cohn* as well as the decisions of bankruptcy courts, *see, e.g., Woolley*, 145 B.R. at 834, this Court concludes that proof of reckless indifference to the truth will satisfy both the knowledge and intent to deceive prongs of § 523(a)(2)(A).

Plaintiffs may prevail, therefore, if they have demonstrated by a preponderance of the evidence that debtor was recklessly indifferent to his representation. "Reckless conduct refers to unreasonable conduct in disregard of a known or obvious risk from which it is highly probably that harm would follow." *In re Woolley*, 145 B.R. at 834 (quoting Prosser & Keeton On Torts, 213 (5th ed. 1984)). "It is usually accompanied by a conscious indifference to the consequences. In contrast, negligence is

characterized as mere thoughtlessness or inadvertence or simple inattention." *Id.* Hence, "[w]here the knowledge element is based on recklessness, the conduct must exceed negligence and rise to the level of reckless disregard for truth. . . . Recklessness is usually determined by a pattern of conduct." *Id.* (citations omitted). Lastly, as the Eighth Circuit has held, if the totality of the circumstances exhibit a debtor's reckless disregard of the truth, a finding of intent or knowledge cannot be overcome simply by an "unsupported assertion of honest intent." *In re Van Horne*, 823 F.2d 1285, 1287 (8th Cir. 1987).

Debtor argues that there was no pattern of conduct evincing recklessness on his part, and that at worse he was negligent. In support of that position, he seeks to distinguish *In re Woolley*, 145 B.R. at 834, where a bankruptcy court in the Eastern District of Virginia found that a debt was non-dischargeable because of the debtor's fraudulent representation under § 523(a)(2)(A). There the debtor induced the plaintiff to invest in an oil well by stating on many different occasions that the well produced 900 barrels per day, when the well actually produced much less. *Id.* The debtor had believed that the representations he made were accurate. Nevertheless, the court concluded that he had acted with reckless indifference to the truth because

> he had no way of knowing whether the statement [concerning profitability] was reasonably accurate . . . he knew nothing about the oil and gas industry. He made no investigation of data on which to make his profit/risk statements about [one of the wells]. For over one year he never inquired about any production data on either [of the wells] . . . [he] must have known that his continuing representations, on which [plaintiff] relied to his detriment, had no reasonable factual basis.

Id. at 835. The court was also persuaded that the debtor's conduct was reckless because he had consistently and repeatedly represented to the plaintiff that the wells were profitable. *Id.* Moreover, the Court considered the debtor's conduct "in light of his prior business experience;" he had an advanced business degree, had been a member of the business faculty of a local

university and had previously been employed as a financial manager at two large Virginia corporations. *Id.* Based on these considerations, the court concluded that his behavior constituted more than mere negligence, and instead rose to the level of reckless disregard for the truth. *Id.*

The Court acknowledges that this case does not squarely fit within *Woolley*. Unlike the debtor in that case, Cohen had had little prior experience as a landlord and no formal training or education pertaining to the ownership and management of real estate when he purchased the property at issue. Furthermore, the *Woolley* debtor had repeatedly made affirmative misrepresentations. In contrast, Cohen's misrepresentation occurred once, when he set the rent at a price above the legal limit; arguably he committed a misrepresentation every time he deposited the plaintiffs' rent checks. In any event, this scenario is clearly different from that in *Woolley*.

Nevertheless, this Court concludes that Cohen engaged in a pattern of conduct which exhibited recklessness. At the time the debtor made his first real estate housing purchase in October, 1984, he was inexperienced in owning and managing property. It is also true that the Monroe property, in which all the plaintiffs did or still do reside was only his second purchase. However, by January, 1987 Cohen owned and operated or was currently owning and operating somewhere between 32 and 40 rental units. Trans. at 49-68. 7 out of the 9 plaintiffs in this case moved into their apartments in January 1987. Trans. at 17-35. By the time he was setting the rent for most of the plaintiffs, he had had two years of real estate experience.

Significantly, Cohen admitted that when he fixed the rents for the plaintiffs he knew that a rent control ordinance existed which governed the amount a landlord could charge a tenant. Trans. at 69. Yet he never contacted the rent control board to determine how that ordinance applied to his activity. Trans. at 52. He never spoke with an attorney even though he had been represented by counsel when he purchased the Monroe Property. Nor did he ever obtain a copy of or read the ordinance. Trans. at 72. Based

on conversations he had with other landlords, he believed that he could charge new tenants whatever he wanted but could only raise the rent of existing tenants six percent annually. Trans. at 52. Yet he never, in any of the conversations he had with other landlords, asked or discussed what amount under the ordinance he could charge new tenants. Trans. at 71. When it redounded to his benefit, Cohen found time to obtain the correct legal information: upon the increase of real property taxes and water charges by the municipality, he successfully requested and obtained permission from the rent control board to surcharge his tenants to reflect those increases. Trans. at 70. He did this not once but twice—in 1986 and again in 1988. *Id.*

Thus the debtor was not incapable of determining how the rent control ordinance affected the rents he could establish. Yet, when it was to his disadvantage, he remained "ignorant." Through his repeated discussions with other landlords or the opportunities he had to consult with an attorney or during his various dealings with the rent control board or perhaps by obtaining a copy of the ordinance which he knew governed his Hoboken property, he could, and moreover should, have learned that the ordinance limited his ability to set the rents of new tenants. This Court concludes that his conduct amounted to a reckless indifference to the truth sufficient to satisfy both the knowledge and intent elements of § 523(a)(2)(A). Because Cohen acquired the debt he owes the plaintiffs through a false representation, that debt is non-dischargeable.

II. The Applicability of the New Jersey Consumer Fraud Act

The Consumer Fraud Act, N.J.S.A. 56:8-2, provides a cause of action to individuals who have been the victim of fraud "in connection with the sale or advertisement of any merchandise or real estate . . ." Bankruptcy Judge Gambardella held that plaintiffs stated a valid cause of action under this Act, and that the debtor had violated the Act. Debtor argues that as a matter of law the Act is inapplicable, and that he did not violate it. Plaintiffs argue to the contrary. The following will address the

Act's applicability while the next section will consider the bankruptcy court's determination that the debtor violated the Act.

In *49 Prospect Street Tenants Association v. Sheva Gardens*, 227 N.J. Super. 449, 465, 547 A.2d 1134 (1988), the New Jersey Appellate Division held that "[t]he plain language of the [Consumer Fraud Act] in its present form requires a conclusion that it applies to landlords as 'sellers' and tenants as 'consumers' since it applies to the rental of real estate." *See also 316 49 St. Associates Limited Partnership v. Galvez*, 269 N.J. Super. 481, 491, 635 A.2d 1013 (App. Div. 1994) ("The Consumer Fraud Act has been held applicable to the landlord-tenant relationship"). Moreover, the statute applies to the inducement of the landlord-tenant relationship as well as any conduct after that relationship has been contractually established. *Id.* at 466, 547 A.2d 1134.

The debtor argues that though the statute was held to apply to landlord-tenant disputes in both *Sheva Gardens* and *Galvez*, it does not apply to this dispute because the facts of this case are different from the facts of those cases. This argument borders on the frivolous. The Court finds nothing in either of these opinions which states or implies that the Act's applicability to the rental of residential real estate is confined to the facts of these cases. Indeed, as the Bankruptcy Judge correctly noted, *Sheva Gardens* states that the Act will apply to "extreme conduct of landlords sufficient to meet the condemned commercial practices set forth in N.J.S.A. 56:8-2." [227 N.J. Super. at 469, 547 A.2d 1134.] Thus, the Sheva court did not limit the Act's landlord-tenant application to habitability violations but instead simply focused on the language of [the Act]. *In re Cohen*, 185 B.R. at 184. The argument that the Act does not apply is without merit.

III. Violation of the New Jersey Consumer Fraud Act

Under the Consumer Fraud Act, N.J.S.A. 56:8-2, defendants are liable for treble damages for engaging in "unlawful practices," which are defined as

> [t]he act, use or employment by any person of any unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation or the knowing concealment or suppression or omission of any material facts with intent that others will rely upon such concealment, suppression or omission . . . or with the subsequent performance of such person as aforesaid, whether or not any person has in fact been misled, deceived or damaged thereby . . .

In *Cox v. Sears Roebuck & Co.*, the New Jersey Supreme Court addressed what plaintiffs must demonstrate to establish liability under the Act. 138 N.J. 2, 647 A.2d 454 (1994). "Unlawful practices fall into three general categories: affirmative acts, knowing omissions, and regulation violations." *Id.* at 17, 647 A.2d 454. "When the alleged consumer-fraud violation consists of an affirmative act, intent is not an essential element . . . However, when the alleged consumer fraud consists of an omission, the plaintiff must show that the defendant acted with knowledge, and intent is an essential element of the fraud." *Id.* (citations omitted). Included within the category of "affirmative acts" are "any unconscionable commercial practice, deception, fraud, false pretense, false promise, [or] misrepresentation." N.J.S.A. 56:8-2.

The Bankruptcy Court found that the debtor had engaged in an affirmative act—either an unconscionable commercial practice or fraud—and therefore had violated the statute. The debtor renews arguments advanced below that he is not liable under the Act because he did not possess the intent to defraud, and that "reckless disregard" does not satisfy the intent requirement. The plaintiffs argue that the bankruptcy court's decision should be upheld because the debtor committed an affirmative act or a knowing omission under the Act, either of which subjects him to liability.

As previously stated, certain of the acts listed in the Consumer Fraud Act, such as "fraud," are deemed "affirmative acts" and do not require proof of intent. *Cox*, 138 N.J. at 17-18, 647 A.2d

454. Thus "fraud" under the Consumer Fraud Act must necessarily be subsumed within "false pretenses, a false representation, or actual fraud" found in 11 U.S.C. § 523(a)(2)(A) because the latter terms do require proof of intent. This Court has already decided that the debt owed to plaintiffs is non-dischargeable because it was acquired through "false pretenses, a false representation or actual fraud." Consequently, the debtor has also violated the Consumer Fraud Act.

That this Court's determination under 11 U.S.C. § 523(a)(2)(A) necessarily means that the debtor violated the Consumer Fraud Act is buttressed by the strong language of the New Jersey Supreme Court's opinions, *Cox*, 138 N.J. at 16, 647 A.2d 454, and *Kugler v. Romain*, 58 N.J. 522, 279 A.2d 640 (1971), which emphasize the remedial nature of the Act and the desire by the legislature to protect consumers. "Although initially designed to combat 'sharp practices and dealings' that victimized consumers by luring them into purchases through fraudulent or deceptive means, the Act is no longer aimed solely at 'shifty, fast-talking and deceptive merchant[s]' but reaches "nonsoliciting artisans" as well. Thus the Act is designed to protect the public even when a merchant acts *in good faith*." *Cox*, 138 N.J. at 16, 647 A.2d 454 (emphasis added). Accordingly, the Consumer Fraud Act is applicable to this case, the debtor has committed fraud forbidden by the Act and is therefore liable for treble damages.

Alternatively, this Court also affirms the bankruptcy court's conclusion that the debtor committed an "unconscionable commercial practice," another of the "affirmative acts" of the Consumer Fraud Act which do not require "intent." The *Kugler* Court held that "[t]he standard of conduct that the term 'unconscionable implies is lack of good faith, honesty in fact and observance of fair dealing.'" *Id.* at 544, 279 A.2d 640. The reckless disregard for the truth the debtor displayed when he set rents above the legal limits—despite his knowledge that the Hoboken Rent Control Ordinance governed his property, despite his repeated discussions with other landlords about seemingly every other aspect of that Ordinance except for its limits on his

ability to set rents to new tenants, despite his two successful petitions to the Rent Control Board to surcharge his tenants for increases in taxes and water charges—coupled with the relative lack of education of the plaintiffs leads this Court to conclude that the debtor acted in bad faith and engaged in an unconscionable commercial practice. Consequently, on this ground, he has violated the Act and is liable to plaintiffs for treble damages.

IV. Dischargeability of the Treble Damage Award

The debtor argues that the mandatory treble damages that are imposed upon him for violating the New Jersey Consumer Fraud Act, *Cox*, 138 N.J. at 24, 647 A.2d 454, are punitive and therefore dischargeable under 11 U.S.C. § 523(a)(2)(A). He acknowledges that the Third Circuit has not ruled on whether punitive damages are dischargeable under this provision, and that the other Circuits are split over this question. He thus urges this Court to follow the Ninth Circuit's *In re Levy*, 951 F.2d 196 (9th Cir. 1991), *cert. denied*, 504 U.S. 985, 112 S.Ct. 2965, 119 L.Ed.2d 586 (1992), which held that punitive damages are dischargeable. The plaintiffs counter that, even though the Bankruptcy Court addressed this issue, the debtor failed to raise it below and consequently has waived his claim. They further argue that the statutory treble damages are not punitive damages under New Jersey law and therefore are non-dischargeable under § 523(a)(2)(A). And, even if this Court considers this award punitive, it should follow the Eleventh Circuit's *In re St. Laurent*, 991 F.2d 672 (11th Cir. 1993), which held that punitive damages are not dischargeable under § 523(a).

As a threshold matter, this Court finds that the debtor has not waived this argument. Though he did not raise it below, the Bankruptcy Judge addressed it and it is part of the record on appeal to this Court. Accordingly, it will be addressed on the merits.

Plaintiffs contend correctly, the Court concludes, that statutorily imposed treble damages obtained by false pretenses are not dischargeable under § 523(a)(2)(A). Their rationale is that statutory damages and punitive damages are different under New

Jersey law. However, because the Court is construing the terms of § 523(a)(2)(A), a federal statute, this is a matter of federal, not state law. *See, e.g., Molzof v. United States*, 502 U.S. 301, 305, 112 S.Ct. 711, 714, 116 L.Ed.2d 731 (1992) ("the meaning of the term 'punitive damages' as used in [the Federal Tort Claims Act], a federal statute, is by definition a federal question").

The issue before the Court, therefore, is whether non-compensatory statutory damages are dischargeable under § 523(a)(2). In *In re Levy*, 951 F.2d at 198, the Ninth Circuit examined the language of this provision, which precludes the discharge of any debt "to the extent obtained by" fraud, false pretenses or a false representation. It decided that the jury's punitive damage award was dischargeable because it did not constitute a debt obtained by fraud—only the amount of compensatory damages which were actually obtained by fraud could not be discharged. *Id.* The Eleventh Circuit in *In re St. Laurent*, 991 F.2d at 678, reached the opposite conclusion. That Court focused on "debt" and whether that term was sufficiently broad to include a judgement requiring the payment of both compensatory and punitive damages. *Id.* at 679. It concluded that it is, and therefore that such a judgement is not dischargeable. *Id.* In so doing, *St. Laurent* relied upon the "fresh start" policy of the Bankruptcy Code which enables insolvent debtors to reorder their affairs and to start a new life unencumbered by debt. *Id.* at 680. However, this "opportunity for a completely new beginning" may only be availed by the "honest but unfortunate debtor." *Id.* (citing *Grogan v. Garner*, 498 U.S. 279, 286-87, 111 S.Ct. 654, 659, 112 L.Ed.2d 755 (1991)). Consequently, a debtor liable for punitive damages because of his or her fraud should not be permitted to have that debt discharged. *Id.*

This Court finds the *St. Laurent* view to be the more cogent, and accordingly affirms the bankruptcy court's decision. In this case discharge is particularly inappropriate. Both *St. Laurent* and *In re Levy* concern situations where either a judge or a jury exercised discretion to award punitive damages. Here the New Jersey Consumer Fraud Act mandates that treble damages be

imposed for violating its terms. Unlike a discretionary imposition of punitive damages, the non-compensatory aspect of the award in this case was codified and therefore entirely foreseeable by the debtor at the time he made the false representations to the plaintiffs. In this sense it may properly be seen as the debt he incurred through his conduct, rather than as punishment.

The treble damage award under the New Jersey Consumer Fraud Act is not dischargeable in bankruptcy.

CONCLUSION

For the reasons stated it is on January 24, 1996:

ORDERED that decision of the bankruptcy court is **affirmed**.

SO ORDERED.

**UNITED STATES BANKRUPTCY COURT,
DISTRICT OF NEW JERSEY.**

In re Edward S. COHEN, Debtor.

**Hilda DE LA CRUZ, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval, Hector Santiago, Santia Santos, Elba Saravia, Elvia Siguenzia, Enilda Tirado, Plaintiffs,
v.
Edward S. COHEN, Defendant.**

Bankruptcy No. 90-25340.
Adv. No. 91-2094.

June 19, 1995.

OPINION

ROSEMARY GAMBARDELLA, Bankruptcy Judge.

The matter before the Court is to determine damages in the instant adversary proceeding. The following constitutes the Court's findings of fact and conclusions of law.

FACTS

On November 12, 1993, the Court conducted a trial in the matter of *Hilda De La Cruz et al. v. Edward S. Cohen*, Adv. No. 91-2094.

On October 24, 1994, the Court issued a written opinion, 185 B.R. 171 (the "Opinion"),[1] rendering the debt in question nondischargeable under § 523(a)(2)(A). As to damages, the Court noted that a hearing would be held to make the determination on the amount.

[1] For a full statement of the facts, see the Opinion.

For purposes of the damages hearing, the following parts of the Opinion are pertinent:

(i) None of the Plaintiffs were born in the continental United States or spoke English as their native language or graduated college, *see* Opinion, at pp. 173-74;

(ii) The parties agreed that the written record of the Hoboken Rent Leveling Board represents the determination that the Board made with respect to the alleged rental overcharges, *see id.*, at p. 175;

(iii) Section 523(a)(2)(A) requires proof of actual fraud, which meant that Plaintiffs had to establish by a preponderance of the evidence that: (1) Edward S. Cohen (the "Debtor") obtained money, property or services through a material misrepresentation; (2) the Debtor, at the time of the transaction, had knowledge of the falsity of the misrepresentation or reckless disregard or gross recklessness as to its truth; (3) the Debtor made the misrepresentation with intent to deceive; (4) the Plaintiffs reasonably relied on the representation; and (5) the Plaintiffs suffered loss, which was proximately caused by the Debtor's conduct; *see id.*, at p. 177.

The Court ruled the debt in question nondischargeable under § 523(a)(2)(A) because the Court found, *inter alia*, that: (i) the Debtor made a misrepresentation regarding the amount of rent, *see id.*, at p. 177; (ii) the Plaintiffs reasonably relied on the representation that the amount of rent they were asked to pay was within the bounds of the law, *see id.*, at p. 177; and (iii) the Debtor's reckless disregard for the truth satisfied both the knowledge and intent to deceive elements of actual fraud, *see id.*, at pp. 178-79.

On December 9, 1994, the Plaintiffs filed a brief with respect to damages ("Plaintiffs Brief"). Firstly, the Plaintiffs note that there is a dispute as to the total amount of rent the Plaintiffs paid, and thus, the total overpayment. *See* Plaintiff's Brief, at 1. The Plaintiffs, however, concede that the amount should be reduced

and have attached a table setting forth the reduced calculations. *See id.*, at 1-2 and Appendix A (damages table).

The Plaintiffs argue that the principle legal issue is the applicability of the New Jersey Consumer Fraud Act (the "Act").[2] The Act provides for imposition of treble damages for violations of the Act. The Plaintiffs contend that the Act is applicable to the instant case, and therefore, ask this Court to award them treble the amount of the overpayments.

On March 17, 1995, the Debtor submitted a brief with respect to damages ("Debtor's Damages Brief"). First, the Debtor argues that the overpayment calculation previously determined by the Hoboken Rent Leveling Board (the "Board") was in error. Next, the Debtor asserts that the "sole legal issue" before the Court is the applicability of the Act. *Id.* The Debtor argues that the Act is inapplicable for the following two reasons: (1) the Act has not been applied to landlord-tenant matters where the violation involves excessive rents charged in violation of a rent control ordinance; and (2) the Plaintiffs cannot establish the elements of fraud under the Act.

On March 27, 1995, a hearing was conducted on these issues. At the hearing, the parties submitted a Stipulation As To Rental Overpayments that was dated March 21, 1995. The Stipulation provided, in pertinent part, that: . . . the determination of the

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[2] Plaintiffs complaint provides in pertinent part:

> 9. The debt owed by defendant to each plaintiff was obtained by false pretenses, a false representation or actual fraud.
> WHEREFORE, plaintiffs demand judgment:
> a. declaring the debts owed to them to be nondischargeable pursuant to 11 U.S.C. § 523(a).
> b. for damages equal to the amount of the overpayment of rent.
> c. for treble damages and reasonable attorneys fees pursuant to the New Jersey Consumer Fraud Act. *N.J.S.A.* 56:8-1 et seq.
> d. for whatever other relief the Court deems equitable and just. *See* Complaint dated February 11, 1991, filed February 14, 1991, at ¶ 9.

Hoboken Rent Leveling Administrator shall be adjusted to reflect the following overpayments:

Plaintiff	Corrected Overcharge Determination
Nelfo C. Jimenez	$ 5,681.50
Elvia Siguenzia	$ 3,319.00
Hilda De La Cruz	$ 5,048.00
Maria Morales	$ 5,310.00
Hector Santiago	$ 5,975.00
Santia Santos	$ 728.00
Gloria Sandoval	$ 5,321.00
Enilda Tirado	$ -0-
Total	$31,382.50

See Stipulation dated March 21, 1995, filed March 27, 1995, at ¶ 6.

Due to the Stipulation, the only remaining issue before the Court was the applicability of the Act and the Court reserved decision on the matter.

DISCUSSION

I. The Act Can Be Applied To the Rental Of Residential Apartments

N.J.S.A. 56:8-2 reads in pertinent part: The act, use or employment by any person of any unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation, or the knowing, concealment, suppression or omission of any material fact with intent that others rely upon such concealment, suppression or omission, in connection with the sale or advertisement of any merchandise or real estate, or with the subsequent performance of such person as aforesaid, whether or not any person has in fact been misled, deceived, or damaged thereby, is declared to be an unlawful practice; . . . *N.J.S.A.* 56:8-2. The statutory language of *N.J.S.A.* 56:8-2 encompasses the landlord-tenant relationship. *49 Prospect St. Tenants Ass'n. v. Sheva Gardens, Inc.*, 227 N.J. Super. 449,

461-69, 547 A.2d 1134 (App. Div. 1988); *see also, 316 49 St. Assoc. Ltd., Partnership v. Galvez*, 269 N.J. Super. 481, 491-92, 635 A.2d 1013 (App. Div. 1994), *cert. denied*, 137 N.J. 164, 644 A.2d 612 (1994).[3] Specifically, the Sheva court extended the definition of "sellers" and "consumers" to include landlords and tenants when the landlord is engaged in the "sale" or commercial enterprise of rental of real estate. *Id.* The Sheva court went on to explain that "[w]hile there may be some question as to the isolated rental of an apartment in a two-family house, such as the isolated sale of a single-family residence by its owners in *DiBernardo v. Mosley*, 206 N.J. Super. 371, 502 A.2d 1166 (App. Div. 1986), *certif. denied*, 103 N.J. 503, 511 A.2d 673 (1986), defendants in this case as landlord of a 55-unit, four-story apartment building, as well as several other apartment buildings, are obviously engaged in a commercial enterprise with the tenants as consumers." *Id.* at 465, 547 A.2d 1134.

As explained by the Sheva court, the Act originally provided that a "sale" included "any sale, offer for sale, or attempt to sell". *Id.* at 463, 547 A.2d 1134. In 1967, the term "sale" was amended to apply to "any sale, rental or distribution, offer for sale, rental or distribution or attempt directly or indirectly to sell, rent or distribute." *Id.* at 464, 547 A.2d 1134. Notably, the 1967 amendment also broadened the scope of the Act by inserting the language "or with the subsequent performance of such person as aforesaid." *Id.* Thus, as pertains to the rental of real estate, condemned practices relate not only to the initial sale or advertisement, but also to the landlord's subsequent performance. *New Mea Const. Corp. v. Harper*, 203 N.J. Super. 486, 501, 497 A.2d 534 (App. Div. 1985). The requisite standard mandates in part the maintenance of basic requirements of habitability. *Sheva*, 227 N.J. Super. at 468, 547 A.2d 1134.

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[3] The Appellate Division in *Galvez* cited *Sheva* with approval in noting that the Act applied to landlord-tenant relationships and remanding the case for a determination on whether the Act was violated. 269 N.J. Super. at 491-92, 635 A.2d 1013.

Arguments asserting conflict between the Act and existing landlord-tenant statutes were considered inapt by the *Sheva* court. The *Sheva* court agreed that "there should not be duplicative recoveries for the same ascertainable loss, but conclude[d] that the existence of other statutory remedies for some of defendants' conduct does not bar applicability of the Consumer Fraud Act to this landlord-tenant relationship." *Id.* at 467, 547 A.2d 1134 (citations omitted). Moreover, the *Sheva* court distinguished cases wherein the treble damages were not imposed[4] by citing the absence of both a singular administrative agency regulating landlord-tenant practices as well as a designated forum for relief. *Id.* at 468-69, 547 A.2d 1134. Lastly, in response to concern that its decision would invite abuse by tenants, the *Sheva* court emphasized that the Act would apply only in cases where the landlord's extreme conduct is deemed to satisfy the condemned commercial practices standard set forth in *N.J.S.A.* 56:8-2. *Id.* at 469, 547 A.2d 1134.

Therefore, under New Jersey case law, this Court finds, as argued by the Plaintiffs, that the Act can be applied to the type of landlord-tenant relationship present in the case at bar because Edward S. Cohen, the Debtor, was in the business of managing and operating real estate housing. *See* Opinion, at 172. The Debtor has argued that the Act is inapplicable to the type of

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[4] In *Daaleman v. Elizabethtown Gas Co.*, 77 N.J. 267, 390 A.2d 566 (1978), a consumer brought suit under the Consumer Fraud Act on behalf of gas customers against a privately owned public utility company operating under the jurisdiction of the Board of Public Utility Commissioners of the State of New Jersey (PUC). The *Daaleman* court declined to impose treble damages under circumstances where the court determined that the subject matter of the plaintiff's Complaint was within the exclusive jurisdiction of the PUC and not cognizable under the Consumer Fraud Act. The court found that the following factors existed: alternate remedies, concurrent state regulation, jurisdiction of another state agency, and that punitive damages would be counterproductive because it is the public users of the utility service on whom the punitive award would fall. 77 N.J. at 272- 73, 390 A.2d 566.

landlord-tenant matter involved in the present case, namely, excessive rents charged in violation of a rent control statute. The Debtor contends that the *Sheva* ruling, which expressed that the Act was applicable to the landlord-tenant relationship, should be interpreted as limited to the circumstances of the *Sheva* case.

In *Sheva*, the court held that the Act applied where the conduct of the landlord, specifically the landlord's failure to comply with habitability standards, was sufficient to meet the condemned commercial practices set forth in *N.J.S.A.* 56:8-2. 227 N.J. Super. at 469, 547 A.2d 1134. The Debtor urges that *Sheva* should be interpreted as limiting the situations where the Act can be applied to landlords. However, the Sheva court does not indicate such a narrow application of the Act. The *Sheva* court states that the Act will apply to "extreme conduct of landlords sufficient to meet the condemned commercial practices set forth in *N.J.S.A.* 56:8-2." *Id.* Thus, the *Sheva* court did not limit the Act's landlord-tenant application to habitability violations but instead simply focused on the language of *N.J.S.A.* 56:8-2.

A recent decision by the Appellate Division, in *316 49 St. Assocs. Ltd. Partnership v. Galvez*, 269 N.J. Super. 481, 635 A.2d 1013 (App. Div. 1994), confirms the conclusion that Sheva was not meant to be interpreted as limiting the Act's application in the landlord-tenant context. In *Galvez*, the Appellate Division reaffirmed application of the Act to landlord-tenant relationships by remanding to the trial court the question of whether a landlord violated the Act where a tenant alleged that an option to purchase, which mandated supplemental monthly payments in excess of the rent control ordinance, constituted a violation of the Act. 269 N.J. Super. at 491-92, 635 A.2d 1013. Therefore, the decision by the Appellate Division in *Galvez* evidences that the application of the Act is not limited to issues of habitability, and as a result, the Debtor's argument is rejected.

In sum, the Court is convinced that, based on New Jersey law, the Plaintiffs situation may properly fall within the scope of the Act.

II. Fraud Has Been Established Under the Act

The legislative intent behind the Act was to provide victimized consumers with a remedy in commercial transactions. Specifically, the Act aims "to prevent deception, fraud, or falsity, whether by acts of commission or omission in connection with sale and advertisement of merchandise and real estate." *Fenwick v. Kay American Jeep, Inc.*, 72 N.J. 372, 376-377, 371 A.2d 13 (1977). In order to effectuate the protection of consumers, the Act is construed liberally. *State v. Hudson Furniture Co.*, 165 N.J. Super. 516, 520, 398 A.2d 900 (App. Div. 1979). In concert with this legal interpretation, violation of the Act does not necessitate a showing of actual deceit or fraudulent act; any unconscionable commercial practice is prohibited. *Skeer v. EMK Motors, Inc.*, 187 N.J. Super. 465, 470, 455 A.2d 508 (App. Div. 1982). While the Act does not define the term "unconscionable commercial practice," the New Jersey Supreme Court has opined that "the standard of conduct contemplated by the unconscionability clause is good faith, honesty in fact and observance of fair dealing." *Kugler v. Romain*, 58 N.J. 522, 544, 279 A.2d 640 (1971).

As originally adopted, the Act was limited to prosecution by the Attorney General. *Meshinsky v. Nichols Yacht Sales, Inc.*, 110 N.J. 464, 472, 541 A.2d 1063 (1988). In order to maintain an action the Attorney General is required to show proof of violation; however, it is not necessary for the Attorney General to show that the victimized consumer had "in fact been misled, deceived or damaged thereby. . . ." *Id.* at 473, 541 A.2d 1063 (quoting *N.J.S.A.* 56:8-2). The 1971 amendment provided for a private right of action which enabled the successful plaintiff to recover, in addition to any other appropriate legal or equitable relief, treble damages, reasonable attorneys' fees, filing fees, and costs. *Id.* In contrast to actions instituted by the Attorney General, a private plaintiff must demonstrate an "ascertainable loss . . . as a result of" the unlawful conduct in order to prevail. *Id.*

Recently, the New Jersey Supreme Court explained:

> To violate the Act, a person must commit "an unlawful practice" as defined in the legislation. Unlawful practices fall into three general categories: affirmative acts, knowing omissions, and regulation violations. The first two are found in the language of *N.J.S.A.* 56:8-2, and the third is based on regulations enacted under *N.J.S.A.* 56:8-4.[5] A practice can be unlawful even if no person was in fact misled or deceived thereby. The capacity to mislead is the prime ingredient of all types of consumer fraud.
>
> When the alleged consumer-fraud violation consists of an affirmative act, intent is not an essential element and the plaintiff need not prove that the defendant intended to commit an unlawful act. However, when the alleged consumer fraud consists of an omission, the plaintiff must show that the defendant acted with knowledge, and intent is an essential element of the fraud.

Cox v. Sears Roebuck & Co., 138 N.J. 2, 17-18, 647 A.2d 454 (1994) (internal citations omitted).

Affirmative acts include unconscionable commercial practice, deception, fraud, false pretense, false promise or misrepresentation. *N.J.S.A.* 56:8-2. Concealment, suppression, or omission of any material fact constitute acts of omission. Id. As noted by the *Cox* court, the principle distinction between the affirmative act and knowing omission categories is that while intent is not a requirement for substantiating affirmative acts of consumer fraud, acts of omission are restricted to incidents where the defendant manifests knowledge and intent. 138 N.J. at 17-18,

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[5] *N.J.S.A.* 56:8-4 entitled "Additional Powers" provides in pertinent part: To accomplish the objectives and to carry out the duties prescribed by this act, the Attorney General, in addition to other powers conferred upon him by this act, may . . . promulgate such rules and regulations . . . as may be necessary, which shall have the force of law. *N.J.S.A.* 56:8-4 (West 1960).

647 A.2d 454; *see also, Fenwick*, 72 N.J. at 377-378, 371 A.2d 13 (same).[6]

Therefore, as noted by the Plaintiffs, the following must be shown to establish an affirmative act or knowing omission violation:[7] (i) an affirmative act constituting an unconscionable commercial practice, deception, fraud, false pretense, false promise or misrepresentation and ascertainable damages resulted; *or* (ii) a knowing omission of a material fact, with an intent that others rely on the deception and ascertainable damages resulted. *See* Plaintiff's Brief, at 5-6 (citing New Jersey Model Jury Charges, Civil § 4.23 (New Jersey Institute for Continuing Legal Education 1992)). Although Plaintiff does not articulate the burden of persuasion, the preponderance of the evidence is the standard for establishing a violation under the Act.[8] *Hyland v. Aquarian Age 2,000, Inc.*, 148 N.J. Super. 186, 191, 372 A.2d 370 (Ch. Div. 1977); *see also, In re Fleet*, 95 B.R. 319, 331 (E.D.Pa. 1989) (citing *Hyland* for rule that preponderance of evidence is standard under Act). In this Court's prior Opinion,

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[6] The Court notes that some courts have interpreted *N.J.S.A.* 56:8-2 as requiring any showing of fraud to be unconscionable, deliberate and knowing. *See Zaro Licensing, Inc. v. Cinmar, Inc.*, 779 F. Supp. 276, 286 (S.D.N.Y. 1991) (citing *DeSimone v. Nationwide Mutual Ins. Co.*, 149 N.J. Super. 376, 380, 373 A.2d 1025 (App. Div. 1977)). The Court respectfully disagrees in light of the cases relied upon which interpret affirmative acts of consumer fraud as not requiring a showing of knowledge and intent.

[7] The third category, regarding regulations enacted under 56:8-4, has not been raised by the parties.

[8] The Court is aware that New Jersey courts traditionally have held that the burden of persuasion for common law fraud is clear and convincing evidence. *See, e.g., Stochastic Decisions, Inc. v. DiDomenico*, 236 N.J. Super. 388, 395, 565 A.2d 1133 (App. Div. 1989), *certif. denied*, 121 N.J. 607, 583 A.2d 309 (1990); *R.A. Intile Realty Co., Inc. v. Raho*, 259 N.J. Super. 438, 475, 614 A.2d 167 (App. Div. 1992). However, preponderance of the evidence appears to be the prevailing burden under the Act.

it was explained that section 523(a)(2)(A) requires proof of actual fraud, which meant that Plaintiffs had to establish be a preponderance of the evidence that: (1) the Debtor obtained money, property or services through a material misrepresentation; (2) the Debtor, at the time of the transaction, had knowledge of the falsity of the misrepresentation or reckless disregard or gross recklessness as to its truth; (3) the Debtor made the misrepresentation with intent to deceive; and (4) the Plaintiffs reasonably relied on the representation; and (5) the Plaintiffs suffered loss, which was proximately caused by the Debtor's conduct. *See* Opinion, at p. 177 *citing Trump Plaza Associates v. Poskanzer* (*In re Poskanzer*), 143 B.R. 991, 999 (Bankr. D.N.J. 1992); *Southeast Bank v. Hunter* (*In re Hunter*), 83 B.R. 803, 804 (M.D. Fla. 1988); *Comerica Bank-Detroit v. Nahas* (*In re Nahas*), 92 B.R. 726, 729-30 (Bankr. E.D. Mich. 1988); *see also Caspers v. Van Horne* (*Matter of Van Horne*), 823 F.2d 1285, 1287 (8th Cir. 1987); *Citibank South Dakota v. Dougherty* (*In re Dougherty*), 84 B.R. 653, 656 (9th Cir. BAP 1988); *Hong Kong Deposit and Guaranty Co. v. Shaheen* (*In re Shaheen*), 111 B.R. 48, 51 (S.D.N.Y. 1990); *Visotsky v. Woolley* (*In re Woolley*), 145 B.R. 830, 833 (Bankr. E.D. Va. 1991); *Citicorp Credit Services v. Hinman* (*In re Hinman*), 120 B.R. 1018, 1021 (Bankr. D.N.D. 1990); *Notre Dame Federal Credit Union* (*In re Tondreau*), 117 B.R. 397, 400 (Bankr. N.D. Ind. 1989); *Stamford Municipal Employees' Credit Union, Inc. v. Edwards* (*In re Edwards*), 67 B.R. 1008, 1009-10 (Bankr. D. Conn. 1986); *Chase Manhattan Bank v. Carpenter* (*In re Carpenter*), 53 B.R. 724, 729 (Bankr. N.D. Ga. 1985). This Court ruled that the debt in question was nondischargeable under § 523(a)(2)(A) because the Court found, *inter alia*, that: (i) the Debtor made a misrepresentation regarding the legal amount of rent that could be charged for the subject apartments, *see id.*, at p. 177; (ii) the Plaintiffs reasonably relied on the representation that the amount of rent they were asked to pay was within the bounds of the law, *see id.*, at p. 177; and (iii) the Debtor's reckless disregard for the truth satisfied both the knowledge and intent to deceive elements of actual fraud, *see id.*, at pp. 178-79.

Although it seems clear that there has been a violation of the Act based on the Court's earlier ruling, the Debtor has argued that the elements of fraud can not be established under the Act. The Debtor contends that the Court's ruling that the Debtor acted with "reckless disregard" of the truth does not establish that the Debtor's conduct classified as "knowing" which is a required element where the wrongful conduct constitutes an act of omission rather than an affirmative act.[9]

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[9] In its prior Opinion, this Court found:

> The Court finds that the testimony presented at trial sufficiently demonstrates that Cohen *should* have been aware of the rent control ordinance. Cohen may not have had training in the management of rental property, but several incidents in his management experience should have alerted him to the fact that his building was subject to rent control. Cohen testified that, at the time the new tenants moved into his building, he was not aware of any ordinance restricting the amount of rent he could charge a tenant moving in after he purchased the property. He did know, however, that he could not raise the rent of existing tenants by more than six percent. Initially alerted to certain rent restrictions, Cohen could have inquired about any further restrictions from such sources as the attorney representing him in the purchase of the Monroe property or even the Hoboken Board itself.
>
> In fact, as early as 1986, Cohen had demonstrated his ability to ascertain information regarding what he could charge his tenants. He had learned, through his own investigating, that he could surcharge tenants for certain costs, such as water and taxes. Thus, he was clearly aware of the existence of the Hoboken Rent Leveling and Stabilization Board before any of the new tenants moved into the building. He should also have been alerted to the fact that this Board might have authorization over the rents he could charge.
>
> Furthermore, Cohen operated other rental units besides the Monroe Property. Prior to 1987, Cohen had managed up to 32 units, including the Monroe property. Trans. p. 64-65. Later, in November 1987, Cohen purchased property in Union City, which added eight units to his rental properties. Trans. p. 65. The testimony, at trial, adequately demonstrates that, during the period

The Debtor's argument is not persuasive because the Debtor's conduct need not be analyzed under omission standards.[10] *See*

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that Cohen rented the apartments to the new tenants, he owned other rental units besides the Monroe Property and thus, he was familiar with the responsibilities and obligations accompanying the management of rental property.

Thus, Cohen's failure to investigate whether, and to what extent, a rent control ordinance governed the Monroe Property was not merely a careless or negligent oversight on the part of an inexperienced or naive landlord. Instead, Cohen's failure to inquire into the rent control issue and simultaneously charge new tenants what he believed to be fair market value demonstrates a reckless disregard for the truth. Cohen exhibited his ability to obtain information from the Hoboken Board where the result benefitted him and permitted him to pass on his costs. Avoiding any investigation into potential rent control, where the result could be financially detrimental to Cohen, amounts to a reckless disregard for the truth (which was that a rent control ordinance existed).

The Court's finds that Cohen's reckless disregard for the truth as demonstrated by his failure to inquire about rent control satisfies both the knowledge element and the intent to deceive element required under § 523(a)(2)(A). *See* Opinion at pp. 178-79.

[10] The Court notes that an act of omission violation under the Act requires a showing of knowledge and intent to deceive. In the Opinion, this Court made a finding that the Debtor acted with a reckless disregard for the truth that satisfied both the knowledge and intent to deceive elements of actual fraud under § 523(a)(2)(A). The Court has not found a New Jersey case that has ruled that a reckless disregard for the truth can satisfy the Act's omission requirements of knowledge and intent to deceive. *But see Ocean Cape Hotel Corp. v. Masefield Corp.*, 63 N.J. Super. 369, 381, 164 A.2d 607 (App. Div. 1960) (stating "[m]isrepresentation of a present state of mind, with respect to a future matter, may be concluded from the utter recklessness and implausibility of the statement in light of subsequent acts and events") (citation omitted). The lack of New Jersey case law on the issue of whether a finding of a reckless disregard for the truth is sufficient for an action requiring knowledge and intent to deceive is probably due to New

Cox, 138 N.J. at 17-18, 647 A.2d 454; *Fenwick*, 72 N.J. at 377-378, 371 A.2d 13; *Chattin v. Cape May Greene, Inc.*, 243 N.J. Super. 590, 603, 581 A.2d 91 (App. Div. 1990), *aff'd*, 124 N.J. 520, 591 A.2d 943 (1991). As explained by the Cox court,

> . . . the Act specifies the conduct that will amount to an unlawful practice in the disjunctive, as "any unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation, *or* the knowing [ ] concealment, suppression, *or* omission of any material fact * * *." *N.J.S.A.* 56:8-2 (emphasis added). Proof of any one of those acts or omissions or a violation of a regulation will be sufficient to establish unlawful conduct under the Act.

138 N.J. at 19, 647 A.2d 454; *see also, D'Ercole Sales Inc. v. Fruehauf Corp.*, 206 N.J. Super. 11, 22, 501 A.2d 990 (App. Div. 1985).

In defining the unconscionability clause, the New Jersey Supreme Court has stated:

> The standard of conduct contemplated by the unconscionability clause is good faith, honesty in fact and observance of fair dealing. The need for application of the standard is most acute when the professional seller is seeking the trade of those most subject to exploitation—the uneducated, the inexperienced and the people of low incomes. In such a context, a material

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Jersey's recognition of a cause of action for negligent misrepresentation, *see Karu v. Feldman*, 119 N.J. 135, 146, 574 A.2d 420 (1990), which does not require knowledge or an intent to deceive. As a result, it is somewhat unclear whether a showing of reckless disregard for the truth would satisfy the knowing and intent requirements of the Act's omission standard. This Court does suggest that it is likely that a New Jersey court would decide that a reckless disregard for the truth satisfies the knowing and intent requirements of an act of omission due to the underlying policies and objectives of the Act. However, because the Court finds that the affirmative act requirements of the Act can be established, the Court will not analyze the act of omission requirements any further.

> departure from the standard puts a badge of fraud on the transaction and here the concept of fraud and unconscionability are interchangeable.

Kugler v. Romain, 58 N.J. 522, 544, 279 A.2d 640 (1971); *see also, Hundred East Credit Corp. v. Eric Schuster*, 212 N.J. Super. 350, 355, 515 A.2d 246 (App. Div. 1986) (stating "the strongest case for relief [under the Act] is presented by 'the poor, the naive and the uneducated.'") (quoting portions of *Kugler*) *certif. denied*, 107 N.J. 61, 526 A.2d 146 (1986).

Turning to the case at bar, based on the Court's earlier findings as to § 523(a)(2)(A), fraud has been established by a preponderance of the evidence. The Court notes that none of the Plaintiffs were born in the continental United States or spoke English as their native language or graduated college. *See* Opinion, at pp. 4-7. Thus, the instant case presents the type of situation which the New Jersey Supreme Court has expressed that "the concept of fraud and unconscionability are interchangeable." *See Kugler*, 58 N.J. at 544, 279 A.2d 640. As a result, pursuant to the language of *N.J.S.A.* 56:8-2, the Plaintiffs need not show that the Debtor's conduct was knowing to establish an "unlawful practice" under the Act since it is clear that an affirmative act violation has been shown, i.e., unconscionable commercial practice and/or fraud.

This ruling is consistent with the goal of the Act, which is to prevent sellers from engaging in deceptive sales and advertising practices in relation to the marketing of real estate and goods. *See Meshinsky*, 110 N.J. at 472, 541 A.2d 1063; *Fenwick*, 72 N.J. at 378, 371 A.2d 13. Moreover, the Act is remedial and must be "liberally construed in favor of protecting consumers." *In re Fleet*, 95 B.R. 319, 331 (E.D. Pa. 1989) (citing *Barry v. Arrow Pontiac, Inc.*, 100 N.J. 57, 494 A.2d 804 (1985)). These policy and equitable considerations further indicate that a finding of a violation of the Act is justified.

III. Plaintiffs Should Be Allowed To Benefit From the Act's Damage Provisions

Section 56:8-19 provides the remedy for a private party under the Act. The Court notes "that an award of treble damages and attorneys' fees is mandatory under *N.J.S.A.* if a consumer-fraud plaintiff proves both an unlawful practice under the Act and an ascertainable loss." *Cox*, 138 N.J. at 24, 647 A.2d 454. Section 56:8-19 states:

> Any person who suffers any ascertainable loss of moneys or property, real or personal, as a result of the use or practice declared as unlawful under this act or the act hereby amended and supplemented may bring an action or assert a counterclaim therefor in any court of competent jurisdiction. In any action under this section the court shall, *in addition to any other appropriate legal or equitable relief, award threefold the damages sustained by any person in interest. In all actions under this section the court shall award reasonable attorneys' fees, filing fees and reasonable costs of suit.*

N.J.S.A. 56:8-19 (emphasis added). Before calculating the Plaintiffs damages under this provision, this Court must address whether punitive damages for fraud, such as the Act's treble damages provision, can be excepted from discharge by section 523(a)(2)(A). The parties did not raise the question but upon this Court's independent research it was revealed that there is a difference of opinion among courts on this issue. Thus, this Court will discuss the issue briefly.

Based on this Court's research, neither the Third Circuit Court of Appeals, nor lower courts within the circuit, have taken a position on punitive damage awards under section 523(a)(2)(A). Two circuit courts that have considered the issue did not reach similar conclusions. In *In re Levy*, 951 F.2d 196, 198-99 (9th Cir. 1991), *cert. denied*, 504 U.S. 985, 112 S.Ct. 2965, 119 L.Ed.2d 586 (1992), the Ninth Circuit ruled that punitive damages were dischargeable where the grounds of dischargeability were based on findings of fraud under section 523(a)(2)(A). The basis for the *Levy* court's interpretation was that the exception to

discharge under section 523(a)(2)(A) was available only "to the extent obtained by" fraud and not to debts imposed for purposes of punishment. *Id.* (citing § 523(a)(2)(A)). The *Levy* court stated that "the language of the statute suggests that the subsection limits nondischargeability to the amount of benefit to the debtor or loss to the creditor the act of fraud itself created." *Id.*

The Eleventh Circuit reached a different conclusion in *St. Laurent v. Ambrose*, 991 F.2d 672 (11th Cir. 1993). The *St. Laurent* court began its analysis by noting that most courts have found punitive damages dischargeable under § 523(a)(2)(A);[11] however, other courts have disagreed and held that punitive damages for fraud are excepted from discharge by § 523(a)(2)(A).[12] 991 F.2d at 677-78. In finding the § 523(a)(2)(A) exception to discharge equally appropriate to punitive damages, the *St. Laurent* court noted the absence of demonstrated intent by Congress to alter, by the 1984 amendment to § 523(a)(2)(A), the practice of excluding punitive debts from discharge where the compensatory damages resulting from the same conduct were nondischargeable. *Id.* at 679.[13] Further-

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[11] Citing *In re Ellswanger*, 105 B.R. 551, 556 (9th Cir. BAP 1989); *In re Day*, 137 B.R. 335, 341-42 (Bankr. W.D. Mo. 1992); *In re Church*, 69 B.R. 425, 434-35 (Bankr. N.D. Tex. 1987); *In re Larson*, 79 B.R. 462, 465 (Bankr. W.D. Mo. 1987); *In re Suter*, 59 B.R. 944, 947 (Bankr. N.D. Ill. 1986); *In re Cheatham*, 44 B.R. 4, 8-9 (Bankr. N.D. Ala. 1984).

[12] Citing *In re Manley*, 135 B.R. 137, 144-45 (Bankr. N.D. Okla. 1992); *In re Tobman*, 96 B.R. 429 (Bankr. S.D.N.Y. 1989), *rev'd on other grounds*, 107 B.R. 20 (S.D.N.Y. 1989); *In re Daniels*, 94 B.R. 205, 206 (Bankr. S.D. Fla. 1988); *In re Guy*, 101 B.R. 961 (Bankr. N.D. Ind. 1988); *In re Carpenter*, 17 B.R. 563, 564 (Bankr. E.D. Tenn. 1982).

[13] The *St. Laurent* court stated:

> As enacted in 1978, § 523(a)(2)(A) excepted any debt "for obtaining money, property [or] services . . . by . . . actual fraud. . . ." In 1984, however, Congress amended § 523(a)(2)(A) to except from

more, the *St. Laurent* court focused on the "expansive definition of 'debt'" and concluded that "the term 'debt' encompasses an award for punitive damages arising from the same conduct as necessitated an award of compensatory damages. . . ." *Id.* at 680.[14]

The Court agrees with the position espoused by the *St. Laurent* court. In keeping with the broad definition of "debt" under the Bankruptcy Code, all debts arising from the § 523(a)(2)(A) violation should be deemed nondischargeable. As a result, the "debt" that will be deemed nondischargeable under section 523(a)(2)(A) shall include the treble damages as specified by the Act.

In sum, the Plaintiffs have established a violation of the Act and are entitled to three times the amount of overpayment, along

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> discharge "any debt for money, property [or] services . . . *to the extent obtained by* . . . actual fraud. . . ." *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S.C.C.A.N. (98 Stat.) 333, 376 (emphasis added).

991 F.2d at 679.

[14] The *St. Laurent* court stated:

> The Bankruptcy Code defines "debt" as "liability on a claim.", 11 U.S.C. § 101(12). The terms "debt" and "claim" are coextensive. *Johnson v. Home State Bank*, 501 U.S. 78, 85 n. 5, 111 S.Ct. 2150, 2154 n. 5, 115 L.Ed.2d 66 (1991). A "claim" is a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5)(A). A "right to payment" is "nothing more nor less than an enforceable obligation, regardless of the objectives . . . to [be] serve[d] in imposing the obligation." *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 559, 110 S.Ct. 2126, 2131, 109 L.Ed.2d 588 (1990).

991 F.2d at 678 (footnotes omitted).

with reasonable attorneys fees and costs of suit.[15] *See Cox*, 138 N.J. at 24, 647 A.2d 454.

CONCLUSION

The Court finds that a violation of the Consumer Fraud Act has been established. As a result, the Plaintiffs are entitled to a nondischargeable judgment equal to three times the stipulated amount of overpayment, along with reasonable attorneys fees and costs. The stipulated amount of the overcharges totaled $31,382.50. Accordingly, judgment shall enter reflecting treble damages in the total amount of $94,147.50, as apportioned to each plaintiff based on the stipulated amounts of rental overpayments, plus reasonable attorneys' fees and costs to be fixed by the Court. Counsel for the Plaintiffs shall submit a detailed affidavit of services rendered and costs incurred which shall be served on the attorney for the Debtor-Defendant.

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[15] Here the Court is satisfied that the Plaintiffs had been attempting to establish a violation of the Act from the commencement of the dischargeability proceedings. This is important because attorneys fees under the Act are only granted when it is determined that the plaintiff is asserting a violation under the Act. *See Hundred East*, 212 N.J. Super. at 361-62, 515 A.2d 246 (remanded case to determine whether consumer was entitled to attorneys fees under the Act where cause of action under the Act was not asserted until the eighth day of initial trial).

UNITED STATES BANKRUPTCY COURT,
DISTRICT OF NEW JERSEY.

In re Edward S. COHEN, Debtor.

Hilda DE LA CRUZ, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval, Hector Santiago, Santia Santos, Elba Saravia, Elvia Siguenzia, Enilda Tirado, Plaintiffs,

v.

Edward S. COHEN, Defendant.

Bankruptcy No. 90-25340.
Adv. No. 91-2094.

Oct. 24, 1994.

OPINION

ROSEMARY GAMBARDELLA, Bankruptcy Judge.

On November 12, 1993, the Court conducted a trial in the matter of *Hilda De La Cruz et al. v. Edward S. Cohen*, Adv. No. 91-2094. The following constitutes the Court's findings of fact and conclusions of law.

FACTS

From October, 1984 until the end of 1990, the debtor, Edward S. Cohen ("Debtor" or "Defendant" or "Cohen") and his father, Nathan Cohen, managed and operated real estate housing. The first building they purchased was a multiple dwelling located at 502 Jefferson Street in Hoboken, New Jersey (the "Jefferson Property"). *See* Transcript of November 12, 1993 trial (hereinafter "Trans.") p. 47.

At the time Cohen and his father purchased the Jefferson Property, Cohen had no formal education or training regarding

the management and ownership of real estate, although he did graduate from high school.[1] Trans. p. 47 and 44. Essentially, any training Cohen obtained came from the actual experience of owning real estate. Trans. p. 48.

In August 1985, Cohen and his father purchased another multiple dwelling property known as 600 Monroe Street, Hoboken, New Jersey (the "Monroe Property"), which they owned until December 1989. Trans. p. 44. In addition to the two Hoboken properties, the Cohens subsequently purchased the following properties: 717 Palisades Avenue, Union City; 34-40 Plum Street, Paterson, NJ; 210 South Street, Jersey City, NJ; 1026 South Orange Avenue, Newark, New Jersey; 14 Beach Street, Paterson, NJ.[2] Trans. p. 48-50, 64. All of these properties were rental properties occupied at one time or another by tenants. Trans. p. 49.[3]

It was the Debtor's inability to generate sufficient income to cover the expenses of ownership of all of this property that eventually caused the Debtor to seek relief from the bankruptcy court.[4] Trans. p. 50. On November 21, 1990, the Debtor filed a petition for relief under chapter 7 of the Bankruptcy Code. Charles M. Forman was appointed Chapter 7 Trustee by the United States Trustee. The Debtor indicated that the liquidation of all of the properties he owned at the time of filing went to pay his creditors and he was left with nothing. Trans. p. 50.

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[1] Cohen testified that in May 1992 he obtained a bachelor's degree in history. Trans. p. 45.

[2] The Transcript of the proceedings is unclear about which town the Beach Street property was located, but it is mentioned together with the other Paterson properties. *See* Trans. p. 64.

[3] The Cohens also owned two vacant lots in Spring Valley and Klogsberg New York. Trans. p. 50.

[4] The Debtor's father, Nathan Cohen, also filed for relief under the Bankruptcy Code at or about the same time.

Prior to his bankruptcy, however, the Debtor operated the Monroe property, which had 18 apartment units, as a rental property. A superintendent named "Sandy" managed the property and rented out the apartments. Trans. p. 18.

During the period that the Debtor rented the Monroe property, August 1985 through December 1989, a Rent Control ordinance governed the establishment and increase of any rents in Hoboken. *See* Hoboken Code § 155 et seq. (Plaintiffs' Exhibit P-1A). Beginning in September 1989, Cohen received notice from the Rent Leveling and Stabilization Board (the "Board") informing him that he was charging certain of his tenants rent in excess of the legal rent for the apartment. See Plaintiffs' Exhs. P-2 through P-7 and P-9 through P-10 (includes copies of Hoboken Rent Leveling Administrators decisions). The Board provided that Cohen overcharged the following tenants: Hilda De La Cruz, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval,[5] Hector Santiago, Santia Santos, Elba Saravia, Elvia Sequenzia, and Enilda Tirado (hereinafter this group of tenants shall be referred to as "Tenants" or "Plaintiffs").

Hilda De La Cruz began renting an apartment at the Monroe Property in March 1988 at a rate of $500 per month.[6] Trans. p. 16. The Board indicated the legal amount of rent for the apartment was $175 monthly. *See* Exhibit P-2. She further indicated that she was not aware of a rent control ordinance at the time she rented the apartment. Trans. p. 16. Ms. De La Cruz is originally from Santo Domingo and completed school to a grade level of six. Trans. p. 17.

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[5] The plaintiff named herein is Gloria Sandoval, the sister of Raphael Sandoval. It appears that Raphael Sandoval negotiated and rented the apartment for the both of them. Trans. p. 33-34.

[6] Although Plaintiff's Proposed Findings of Fact and Conclusions of Law filed August 12, 1991 (hereinafter "Plaintiff's Proposed Findings") indicates April 1987 as the inception date for Hilda De La Cruz, at trial, she testified that she began living at 600 Monroe Street in March 1988. *Compare* Trans. p. 16 *with* Plaintiff's Proposed Findings ¶ 4.

Elvia Sequenzia moved into an apartment at 600 Monroe Street in April 1988 and paid rent at the monthly rate of $450.[7] Trans. p. 18-19. The Board provided that the legal rate of rent was $221 monthly. *See* Exhibit P-9. At the time she moved in, Ms. Sequenzia was not aware that the rent she was paying exceeded the legal limit. Trans. p. 19. Ms. Sequenzia was born in Ecuador and attended school until grade level six. Trans. p. 19-20.

Nelfo Jimenez and his wife moved into an apartment at 600 Monroe Street on December 31, 1987. Trans. p. 21. Jimenez paid rent in the amount of $500 monthly and had no knowledge at the time he moved in that the legal rate of rent was much less. Trans. p. 21. In fact, the Board determined that the legal rate of rent was $221 monthly. *See* Exhibit P-3. Jimenez emigrated from Santo Domingo and completed school up to grade level six. Trans. p. 22.

In January 1989, Cohen reduced the monthly rent for Mr. Jimenez to $275. Trans. p. 23 Cohen testified that he reduced the rent in return for Mr. Jimenez rendering services as co-superintendent. Trans. p. 58. Mr. Jimenez asserted at trial that Cohen reduced the rent since the Debtor knew that Jimenez went to the rent control Board. Trans. p. 23.

Maria Morales began renting an apartment at the Monroe Property in May 1987 for a monthly rent of $450.[8] Trans. p. 25. The Board provided that the legal rate of rent for the

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[7] Although Plaintiff's Proposed Findings indicates June 1988 as the inception date for Elvia Sequenzia, at trial, she testified that she began living at 600 Monroe Street in April 1988.

[8] The Parties agreed to stipulate that Cohen charged the amounts of rent listed in paragraph four of the Plaintiff's Proposed Findings. Trans. p. 5-6 and 24. In addition, the Court notes that although Plaintiffs Proposed Findings lists Ms. Morales' inception date as August 1987, she stated at trial that she moved into the apartment in May 1987. Compare Trans. p. 25 with Plaintiff's Proposed Findings ¶ 4.

apartment Ms. Morales rented was $190 monthly. See Exhibit P-4. Ms. Morales testified that she was born in Santo Domingo and completed high school. Trans. p. 25. She further testified that she was not aware that the apartment was subject to rent control at the time she rented it. Trans. p. 25.

Hector Santiago moved into 600 Monroe Street in September 1987 and was not aware of any rent control ordinance.[9] Trans. p. 26. The Board determined that the legal rate of rent for Mr. Santiago's apartment was $162 monthly, even though he paid $400 a month to Cohen. *See* Exhibit P-6 and Plaintiff's Proposed Findings ¶ 4. Mr. Santiago emigrated from Santo Domingo and completed school up to the level of grade six. Trans. p. 26.

Enilda Tirado began living at 600 Monroe Street in July 1982.[10] Trans. p. 27. Prior to Cohen's purchase of the property, Ms. Tirado paid monthly rent at a rate of $215. Trans. p. 27. She continued paying $215 a month even after Cohen purchased the property, although the legal rate of rent was only $175 monthly. Trans. p. 28 and Exhibit P-10. Ms. Tirado testified that she did not know anything about rent control when Cohen took over the property. Trans. p. 28. Ms. Tirado was born in Columbia and completed high school. Trans. p. 28.

Santia Santos testified that she moved into 600 Monroe Street in October 1984, although she was not exactly sure of the date.[11]

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[9] The Court notes there is again a discrepancy between the date testified (September 1987) and the date in the Plaintiff's Proposed Findings of Fact (August 1987). *Compare* Trans. p. 26 *with* Plaintiff's Proposed Findings ¶ 4.

[10] The Court notes there is again a discrepancy between the date testified (July 1982) and the date in the Plaintiff's Proposed Findings of Fact (June 1982). *Compare* Trans. p. 27 *with* Plaintiff's Proposed Findings ¶ 4.

[11] The Court notes there is again a discrepancy between the date testified (October 1984) and the date in the Plaintiff's Proposed Findings of Fact (August 1984). *Compare* Trans. p. 29 *with* Plaintiff's Proposed

Trans. p. 29. She further testified that at the time she moved into the apartment she did not know anything about rent control. Trans. p. 29. Ms. Santos paid monthly rent of $250 the entire time she rented an apartment at 600 Monroe Street notwithstanding that the legal rate of rent was only $156 monthly. *See* Plaintiff's Proposed Findings ¶ 4 and Exhibit p-7. Originally born in Puerto Rico, Ms. Santos competed school to grade level six. Trans. p. 30.

The final plaintiff, Gloria Sandoval, was not present at trial. Her brother, Raphael Sandoval, did testify and he claims that he is the one who dealt with the superintendent to rent the apartment for himself and his sister.[12] Trans. p. 33. Mr. Sandoval lived with his sister in the apartment, although she was the named tenant. Trans. p. 33. The Sandovals, originally from Ecuador, moved into the apartment in January 1987.[13] Trans. p. 34-35. Both Gloria and Raphael Sandoval completed school, in Ecuador, to grade level six. Trans. p. 35. Ms. Sandoval paid rent at the rate of $500 per month although the Board provided that the legal rate of rent was $209 monthly. See Plaintiff's Proposed Findings ¶ 4 and Exhibit P-5.

At the time Cohen purchased the property, he was aware of a rent control ordinance. Trans. p. 51 and 68-69. His understanding of the ordinance was that he could not increase rents more than six percent annually for the cost of living for existing tenants, but for new tenants, he believed he could charge fair market value rents. Trans. p. 51-52. Cohen specifically testified

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Findings ¶ 4.

[12] The Court agreed to hear the testimony of Raphael Sandoval and later determine whether it is sufficient proof in support of Plaintiff Gloria Sandoval's claim. Trans. p. 32.

[13] The Court notes there is again a discrepancy between the date testified (January 1987) and the date in the Plaintiff's Proposed Findings of Fact (January 1988). *Compare* Trans. p. 34 *with* Plaintiff's Proposed Findings ¶ 4.

that he was "not aware that there was anything in the Rent Control Ordinance that would limit what [he] could charge if there was a vacancy in the building." Trans. p. 53.

Cohen formulated his understanding of the rent control ordinance from "discussions with other landlords." Trans. p. 52. His understanding, however, was not based on any formal or informal inquiry with the Rent Leveling Board in Hoboken. Trans. p. 53 and 54. Nor did Cohen ever consult with an attorney regarding the rent control ordinance, notwithstanding that he was represented by counsel at the time he purchased the Monroe Property. Trans. p. 53-54 and 72-73. Moreover, Cohen testified that he never obtained a copy of the Rent Control ordinance. Trans. p. 72.

Although Cohen never made a formal investigation of the Rent Control Ordinance with respect to the amount of rent he could charge a new tenant, he did inquire about surcharging tenants for water bills and increased taxes. Trans. p. 69- 72. Apparently, in 1986 and again in 1988, taxes and water charges in Hoboken increased significantly. Trans. p. 70. Cohen was advised by other landlords that rent control could provide some relief for the increased costs. Trans. p. 70 and 71. Cohen was successful in learning that he could surcharge his tenants for increased water bills and taxes, but he testified that it never occurred to him to inquire into the amount of rent he was permitted to charge to a new tenant. Trans. p. 70-72.

Cohen further testified, at trial, that when he received the notice of the Board's decisions regarding the Plaintiffs, he intended to contest the decisions. Trans. p. 77. He did not believe that he would be forced to have to change the rents and he sought legal advice. Trans. p. 77. The Debtor testified that thought that the determinations were not binding until he had an opportunity to rebut them. Trans. p. 78. The appeals, however, were not perfected.[14] Trans. p. 7-8.

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[14] The parties stipulated to this fact. Trans. p. 7-8.

Cohen did not reimburse any of the tenants for the amounts overcharged. Trans. p. 79. With the determination of the Rent Leveling and Stabilization Board that Cohen had been overcharging rent, the Tenants (listed above) commenced the instant adversary proceeding against the Debtor, on February 14, 1991, requesting a determination of nondischargeability with respect to the amounts of rental overcharge. In their complaint, Plaintiffs claimed that the overcharge in rents was obtained through false pretenses, a false representation or actual fraud.

At trial, the Plaintiffs' counsel withdrew the complaint as it concerned the claim of Elba Saravia. Trans. p. 32. In addition, the parties agreed to several stipulations of fact. First, the parties stipulated that the rents set forth in paragraph four of the Plaintiffs' Proposed Findings are the rents charged by the Defendant, Cohen, at the inception of the tenancy for the Plaintiffs.[15] Trans. p. 5-6. The parties agreed that the written record of the Hoboken Rent Leveling Board represents the determination that the Board made with respect to the alleged rental overcharges. Trans. p. 7.

The parties also stipulated that the Plaintiffs were month to month tenants and there was no written lease agreement between any of the Plaintiffs and the Defendant. Trans. p. 7. The parties do not dispute that all of the Tenants spoke Spanish as their native language.[16] Trans. p. 24-25.

Furthermore, the parties stipulated that Cohen made no representations that the rents he charged were the legal rents under the City of Hoboken rent leveling ordinance. Trans. p. 6.

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[15] There was no stipulation that these amounts were paid at all times during each of the Plaintiffs' tenancies. Trans. p. 6.

[16] The Court permitted the use of an interpreter at trial to conduct the examination of the witnesses. The parties stipulated to the acceptability of the interpreter the Plaintiffs presented, even though she was not a certified interpreter of the United States District Court for New Jersey. Trans. p. 5.

The Parties also stipulated that there were no discussions, at the time the apartments were rented, between the Defendant and any of the Plaintiffs about rent control. Trans. p. 7.

Finally, the parties agreed to bifurcate the proceeding so that the Court would determine the dischargeability issue first and subsequently, if necessary, the Court would determine damages. Trans. p. 8. Accordingly, the instant decision addresses only the issue of the dischargeability of the debts owed to the Plaintiffs.[17]

DISCUSSION

I. Standard for § 523(a)(2)(A)

One of the underlying purposes of the Bankruptcy Code is to provide a debtor with a fresh start and the attendant relief from the burden of indebtedness. In light of the policy to release a debtor from virtually all existing debts, courts generally construe exceptions to discharge narrowly against the creditor and liberally in favor of the debtor. *Caspers v. Van Horne* (*Matter of Van Horne*), 823 F.2d 1285, 1287 (8th Cir. 1987); *Horowitz Finance Corp. v. Hall* (*In re Hall*), 109 B.R. 149, 153 (Bankr. W.D. Pa. 1990); *In re Perez*, 94 B.R. 765, 768 (Bankr. M.D. Fla. 1988).

Moreover, under § 523(a) of the Bankruptcy Code, the burden of proof is placed on the creditor who is opposing dischargeability of the obligation. *Grogan v. Garner*, 498 U.S. 279, 285, 111 S.Ct. 654, 657, 112 L.Ed.2d 755 (1991); *see also In re Posta*, 866 F.2d 364, 367 (10th Cir. 1989). The Grogan court indicated that the ordinary preponderance of the evidence standard applies in § 523, since the drafters of § 523 did not prescribe a standard

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[17] At the trial, the Court noted that the late Bankruptcy Judge Daniel J. Moore previously decided, on a pre-trial motion and by order entered September 25, 1991, that there was no right to a jury trial on the nondischargeability issue so that the Plaintiffs' request for trial by jury on the issue of dischargeability was denied. Trans. p. 8.

of proof for the exceptions to discharge. *Grogan*, 498 U.S. at 286-87, 111 S.Ct. at 659-60.[18]

In the case at bar, the Plaintiffs contend that this Court should determine nondischargeable, under 11 U.S.C. § 523(a)(2)(A), the amount of rent the Debtor charged each of the Plaintiffs in excess of the maximum legal amount.[19] Section 523(a)(2)(A) provides:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b) or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> > (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
> >
> > (A) false pretenses, a false representation, or actual fraud, other than a statement representing the debtor's or other insider's financial condition. . . .

This section requires proof of actual fraud, not merely fraud implied in law. *Morin v. McIntyre* (*In re McIntyre*), 64 B.R. 27,

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[18] The preponderance of the evidence standard is used in civil actions between private parties unless "particularly important individual interests or rights are at stake," which mandate the application of a higher standard. *Grogan*, 498 U.S. at 286, 111 S.Ct at 659 (quoting *Herman & MacLean v. Huddleston*, 459 U.S. 375, 389, 103 S.Ct. 683, 691 74 L. Ed. 548(1983)). The Supreme Court further reasoned "that a debtor has no constitutional or 'fundamental' right to a discharge in bankruptcy." *Id.* Moreover, "in the context of provisions designated to exempt certain claims from discharge, a debtor [does not have] an interest in discharge sufficient to require a heightened standard of proof." *Id.* (citations omitted). Therefore, under § 523(a), the creditor must prove by a preponderance of the evidence that the debtor committed the alleged conduct.

[19] By its Complaint, the Plaintiffs also seek damages equal to the amount of the rent overpayment, and treble damages and reasonable attorneys' fees pursuant to the New Jersey Consumer Fraud Act, N.J.S.A. 56:8-1 et seq.

29 (D.N.H. 1986); *Matter of Anderson*, 10 B.R. 296, 297 (Bankr. W.D. Wis. 1981) (citing *In re Taylor*, 514 F.2d 1370, 1373 (9th Cir. 1975)). The elements of actual fraud that the plaintiff must establish, by a preponderance of the evidence, to have a debt declared non-dischargeable under § 523(a)(2)(A), are: (1) that the debtor obtained money, property or services through a material misrepresentation; (2) that the debtor, at the time of the transaction, had knowledge of the falsity of the misrepresentation or reckless disregard or gross recklessness as to its truth; (3) the debtor made the misrepresentation with intent to deceive; (4) the plaintiff reasonably relied on the representation; and (5) that the plaintiff suffered loss, which was proximately caused by the debtor's conduct. *Trump Plaza Associates v. Poskanzer* (*In re Poskanzer*), 143 B.R. 991, 999 (Bankr. D.N.J. 1992); *Southeast Bank v. Hunter* (*In re Hunter*), 83 B.R. 803, 804 (M.D. Fla. 1988); *Comerica Bank-Detroit v. Nahas* (*In re Nahas*), 92 B.R. 726, 729-30 (Bankr. E.D. Mich. 1988); *see also Caspers v. Van Horne* (*Matter of Van Horne*), 823 F.2d 1285, 1287 (8th Cir. 1987); *Citibank South Dakota v. Dougherty* (*In re Dougherty*), 84 B.R. 653, 656 (9th Cir. BAP 1988); *Hong Kong Deposit and Guaranty Co. v. Shaheen* (*In re Shaheen*), 111 B.R. 48, 51 (S.D.N.Y. 1990); *Visotsky v. Woolley* (*In re Woolley*), 145 B.R. 830, 833 (Bankr. E.D. Va. 1991) *Citicorp Credit Services v. Hinman* (*In re Hinman*), 120 B.R. 1018, 1021 (Bankr. D.N.D. 1990); *Notre Dame Federal Credit Union* (*In re Tondreau*), 117 B.R. 397, 400 (Bankr. N.D. Ind. 1989); *Stamford Municipal Employees' Credit Union, Inc. v. Edwards* (*In re Edwards*), 67 B.R. 1008, 1009-10 (Bankr. D. Conn. 1986); *Chase Manhattan Bank v. Carpenter* (*In re Carpenter*), 53 B.R. 724, 729 (Bankr. N.D. Ga. 1985).

In the instant case, the Debtor set forth a certain amount for rent for each of the Plaintiffs who moved into the subject building after Cohen purchased the property (the "new tenants"),[20] based

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[20] The new tenants consist of Hilda De La Cruz, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval, Hector Santiago and Elvia Sequenzia.

on what he believed was the fair market value. The Hoboken Rent Leveling and Stabilization Board, however, clearly determined that these amounts were incorrect and illegal. Thus, this Court finds that the Debtor made a misrepresentation regarding the amount of rent.

Moreover, the new tenants reasonably relied on the representation that the amount of rent they were asked to pay was within the bounds of the law. They were fairly recent immigrants who not only were unfamiliar with the English language but also unaware of any rent control ordinance. Thus, they had no reason to believe anything other than that Cohen's representations were correct and appropriate. These tenants suffered losses proximately caused by the Debtor's conduct.

Despite the false representation and the reasonable reliance of the new tenants on Cohen's false representation, actual fraud requires knowledge of the falsity and an intent to deceive. A showing of reckless indifference will be sufficient to satisfy the knowledge element. *In re Woolley*, 145 B.R. at 834 (citations omitted); *In re Edwards*, 67 B.R. at 1010 (citing *Morimura v. Taback*, 279 U.S. 24, 33, 49 S.Ct. 212, 215, 73 L.Ed. 586 (1929)). To establish knowledge based on recklessness, "the conduct must exceed negligence and rise to the level of reckless disregard for the truth." *In re Woolley*, 145 B.R. at 834. A court may find recklessness based on a pattern of conduct or behavior. Id. (citing *Orval Davis Tire Co. v. Hamm* (*In re Hamm*), 92 B.R. 386, 388 (Bankr. W.D. Mo. 1988)).

In addition, reckless indifference to the truth is sufficient to prove the requisite intent to deceive. *In re Edwards*, 67 B.R. at 1010 (citing *Houtman v. Mann* (*In re Houtman*), 568 F.2d 651, 656 (9th Cir. 1978) and *In re Hospelhorn*, 18 B.R. 395, 398 (Bankr. S.D. Ohio 1981)); *see also Coman v. Phillips* (*In re Phillips*), 804 F.2d 930, 934 (6th Cir. 1986) (misrepresentation made with gross recklessness to truth and knowledge that it would induce loan satisfies element of intent to deceive) and *Hill v. Horst* (*In re Horst*), 151 B.R. 563, 568 (*Bankr. D. Kan. 1993*) (same). Thus, a reckless disregard of the truth of a statement will

fulfill both the knowledge element and the intent to deceive element.

Furthermore, intent may be proven from the surrounding circumstances since direct proof of intent, that is, the Debtor's state of mind, is difficult to prove through direct evidence. *Matter of Van Horne*, 823 F.2d at 1287 (citations omitted). If a plaintiff provides circumstantial evidence of the debtor's state of mind, the Debtor must supply more than an assertion of honest intent to overcome the implications of the circumstantial evidence. *Id.* 1287-88 (citation omitted). If the Debtor's assertion of honest intent is unsupported, the Court must determine whether the debtor's actions "appear so inconsistent with [his] self-serving statement of intent that the proof leads the court to disbelieve the debtor." *Id.* at 1288 (quoting *In re Hunt*, 30 B.R. 425, 441 (M.D. Tenn. 1983)).

The Court finds that the testimony presented at trial sufficiently demonstrates that Cohen should have been aware of the rent control ordinance. Cohen may not have had training in the management of rental property, but several incidents in his management experience should have alerted him to the fact that his building was subject to rent control.

Cohen testified that, at the time the new tenants moved into his building, he was not aware of any ordinance restricting the amount of rent he could charge a tenant moving in after he purchased the property. He did know, however, that he could not raise the rent of existing tenants by more than six percent. Initially alerted to certain rent restrictions, Cohen could have inquired about any further restrictions from such sources as the attorney representing him in the purchase of the Monroe property or even the Hoboken Board itself.

In fact, as early as 1986, Cohen had demonstrated his ability to ascertain information regarding what he could charge his tenants. He had learned, through his own investigating, that he could surcharge tenants for certain costs, such as water and taxes. Thus, he was clearly aware of the existence of the Hoboken Rent Leveling and Stabilization Board before any of the new tenants

moved into the building. He should also have been alerted to the fact that this Board might have authorization over the rents he could charge.

Furthermore, Cohen operated other rental units ~~be~~sides the Monroe Property. Prior to 1987, Cohen had managed up to 32 units, including the Monroe property. Trans. p. 64-65.[21] Later, in November 1987, Cohen purchased property in Union City, which added eight units to his rental properties.[22] Trans. p. 65. The testimony, at trial, adequately demonstrates that, during the period that Cohen rented the apartments to the new tenants, he owned other rental units besides the Monroe Property and thus, he was familiar with the responsibilities and obligations accompanying the management of rental property.

Thus, Cohen's failure to investigate whether, and to what extent, a rent control ordinance governed the Monroe Property was not merely a careless or negligent oversight on the part of an inexperienced or naive landlord. Instead, Cohen's failure to inquire into the rent control issue and simultaneously charge new tenants what he believed to be fair market value demonstrates a reckless disregard for the truth. Cohen exhibited his ability to obtain information from the Hoboken Board where the result benefitted him and permitted him to pass on his costs. Avoiding any investigation into potential rent control, where the result could be financially detrimental to Cohen, amounts to a reckless disregard for the truth (which was that a rent control ordinance existed).

The Court's finds that Cohen's reckless disregard for the truth as demonstrated by his failure to inquire about rent control satisfies both the knowledge element and the intent to deceive

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[21] Cohen testified that the eight units at the Jefferson Street Property were inoperable by January 1987. Trans. p. 65.

[22] At trial, there was some dispute as to when Cohen purchased the 1026 South Orange Avenue property, which may have occurred anywhere from 1986 to 1988. Trans. p. 65-67.

element required under § 523(a)(2)(A). *See In re Edwards*, 67 B.R. at 1010.

In addition, the Court finds that the circumstantial evidence also supports a finding of the intent to deceive. Several of the facts indicate that more than likely Cohen was aware of rent control and that his building was subject to it. Cohen himself testified that he was aware of the existence of a rent control ordinance. Trans. p. 51 and 68-69. He testified that he learned some of his information from discussions with other landlords, including the prior owner of the Monroe Property. Trans. 51-52. It is highly suspect that all of these landlords were aware of the limits on increases to rent for existing tenants, the ability to surcharge tenants for certain costs and the Hoboken Board, but were not aware of the standards for rent controlled apartments. It is also questionable that when Cohen made his investigation with the Hoboken Board, he did not stumble across the fact that his building was subject to rent control.

Thus, this Court finds that Cohen's intent to deceive the new tenants can be inferred from the circumstantial evidence presented at the trial, notwithstanding the fact that Cohen asserted he was unaware of rent control placed upon the subject building. The surrounding circumstances suggest that Cohen was made aware of the potential existence of rent control standards from his discussions with other landlords and inquiries with the Hoboken Rent Leveling and Stabilization Board, even if he did not want to believe his apartments were subject to rent control. As the court in *In re Woolley* noted, "[s]elf delusion, even if existent does not justify baseless representation." *In re Woolley*, 145 B.R. at 835 (quoting *United States v. Amrep Corp.*, 560 F.2d 539, 546 (2d Cir. 1977), *cert. denied*, 434 U.S. 1015, 98 S.Ct. 731, 54 L.Ed.2d 759 (1978)).

This Court concludes that all of the elements of § 523(a)(2)(A) have been met with respect to the new tenants to render the subject debts nondischargeable. Moreover, the Court concludes that sufficient proof exists in the record to include Gloria Sandoval as one of the Plaintiffs, although she did not testify at

trial. The record shows that the Board made a determination that Cohen overcharged Ms. Sandoval and the parties stipulated the amount Cohen actually charged Ms. Sandoval for rent. Also, her brother testified as to when she moved into the Monroe Property.

In addition, the Court finds that, with respect to the existing tenants,[23] Cohen exhibited a reckless disregard for the truth by not investigating whether the current rent met the rent control standards. Cohen's failure to investigate this issue amounts to reckless disregard for essentially the same reasons noted for the new tenants. Cohen had been alerted to the potential rent control and should have investigated whether the prior landlord was comporting with the law. It is particularly significant that at no time during the four years of ownership of the Monroe Property did Cohen investigate the propriety of the rents he charged the existing tenants. Combined with Cohen's other experiences and the exposure to the Hoboken Board, his assumption that the prior landlord was acting according to the law without independent investigation amounts to a reckless disregard for the truth.

Although Cohen did not raise the existing tenants rent he permitted them to continue paying amounts above the legal rate, which effectively amounted to a false representation of the rent.[24] These tenants were unaware of any rent control ordinance and reasonably relied on these false representations. These tenants suffered losses proximately caused by the Debtor's conduct. The Debtor's failure to investigate the accuracy of the rents demonstrates a reckless disregard for the truth, which satisfies the knowledge and intent to deceive elements of actual fraud. The Court concludes that the elements of actual fraud, required under § 523(a)(2)(A) are satisfied with respect to the existing tenants to render the subject debts nondischargeable.

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[23] The existing tenants are Santia Santos and Enilda Tirado.

[24] Cohen did not increase the base amount of rent, but did raise the rents by six percent, ostensibly to cover cost of living increases. Trans. p. 54.

CONCLUSION

The Court finds that the debts owed the Plaintiffs: Hilda De La Cruz, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval, Hector Santiago, Santia Santos, Elvia Sequenzia, and Enilda Tirado as a result of Cohen's charging of rent over the legal rental rate are nondischargeable under § 523(a)(2)(A).

The Court will address the issue of damages in a separate hearing. The trial on the Plaintiffs' damage claims will be conducted on **Thursday, December 22, 1994 at 10:00 a.m.** The parties are to file and serve pre-trial memoranda regarding the issue of damages no later than ten (10) days prior to the scheduled trial date.

An Order shall be submitted in accordance with this Opinion.

RELEVANT STATUTES

11 U.S.C. § 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

(1) for a tax or a customs duty—

(A) of the kind and for the periods specified in section 507(a)(2) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;

(B) with respect to which a return, if required—

(i) was not filed; or

(ii) was filed after the date on which such return was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing—

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive; or

(C) for purposes of subparagraph (A) of this paragraph, consumer debts owed to a single creditor and aggregating more than $1,000 for "luxury goods or services" incurred by an individual debtor on or within 60 days before the order for relief under this title, or cash advances aggregating more than $1,000 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 60 days before the order for relief under this title, are presumed to be nondischargeable; "luxury goods or services" do not include goods or services reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor; an extension of consumer credit under an open end credit plan is to be defined for purposes of this subparagraph as it is defined in the Consumer Credit Protection Act;

(3) neither listed nor scheduled under section 521(1) of this title, with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit—

(A) if such debt is not of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing; or

(B) if such debt is of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request;

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

(5) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or

child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that—

(A) such debt is assigned to another entity, voluntarily, by operation of law, or otherwise (other than debts assigned pursuant to section 408(a)(3) of the Social Security Act, or any such debt which has been assigned to the Federal Government or to a State or any political subdivision of such State); or

(B) such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support;

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

(7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty—

(A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or

(B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition;

(8) for an educational benefit overpayment or loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution, or for an obligation to repay funds received as an educational benefit, scholarship or stipend, unless—

(A) such loan, benefit, scholarship, or stipend overpayment first became due more than 7 years (exclusive of any applicable suspension of the repayment period) before the date of the filing of the petition; or

(B) excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents;

(9) for death or personal injury caused by the debtor's operation of a motor vehicle if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance;

(10) that was or could have been listed or scheduled by the debtor in a prior case concerning the debtor under this title or under the Bankruptcy Act in which the debtor waived discharge, or was denied a discharge under section 727(a)(2), (3), (4), (5), (6), or (7) of this title, or under section 14c(1), (2), (3), (4), (6), or (7) of such Act;

(11) provided in any final judgment, unreviewable order, or consent order or decree entered in any court of the United States or of any State, issued by a Federal depository institutions regulatory agency, or contained in any settlement agreement entered into by the debtor, arising from any act of fraud or defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union;

(12) for malicious or reckless failure to fulfill any commitment by the debtor to a Federal depository institutions regulatory agency to maintain the capital of an insured depository institution, except that this paragraph shall not extend any such commitment which would otherwise be terminated due to any act of such agency; or

(13) for any payment of an order of restitution issued under title 18, United States Code;

(14) incurred to pay a tax to the United States that would be nondischargeable pursuant to paragraph (1);

(15) not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, a determination made in accordance with State or territorial law by a governmental unit unless—

(A) the debtor does not have the ability to pay such debt from income or property of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor and, if the debtor is engaged in a business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business; or

(B) discharging such debt would result in a benefit to the debtor that outweighs the detrimental consequences to a spouse, former spouse, or child of the debtor;

(16) for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a dwelling unit that has condominium ownership or in a share of a cooperative housing corporation, but only if such fee or assessment is payable for a period during which—

(A) the debtor physically occupied a dwelling unit in the condominium or cooperative project; or

(B) the debtor rented the dwelling unit to a tenant and received payments from the tenant for such period, but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case;

(17) for a fee imposed by a court for the filing of a case, motion, complaint, or appeal, or for other costs and

expenses assessed with respect to such filing, regardless of an assertion of poverty by the debtor under section 1915(b) or (f) of title 28, or the debtor's status as a prisoner, as defined in section 1915(h) of title 28; or

(18) owed under State law to a State or municipality that is—

(A) in the nature of support, and

(B) enforceable under part D of title IV of the Social Security Act (42 U.S.C. 601 et seq.).

(b) Notwithstanding subsection (a) of this section, a debt that was excepted from discharge under subsection (a)(1), (a)(3), or (a)(8) of this section, under section 17a(1), 17a(3), or 17a(5) of the Bankruptcy Act, under section 439A of the Higher Education Act of 1965, or under section 733(g) of the Public Health Service Act in a prior case concerning the debtor under this title, or under the Bankruptcy Act, is dischargeable in a case under this title unless, by the terms of subsection (a) of this section, such debt is not dischargeable in the case under this title.

(c)(1) Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), (6), or (15) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), (6), or (15), as the case may be, of subsection (a) of this section.

(2) Paragraph (1) shall not apply in the case of a Federal depository institutions regulatory agency seeking, in its capacity as conservator, receiver, or liquidating agent for an insured depository institution, to recover a debt described in subsection (a)(2), (a)(4), (a)(6), or (a)(11) owed to such institution by an institution-affiliated party unless the receiver, conservator, or liquidating agent was appointed in time to reasonably comply, or for a Federal depository institutions regulatory agency acting in its corporate capacity as a successor to such receiver, conservator,

or liquidating agent to reasonably comply, with subsection (a)(3)(B) as a creditor of such institution-affiliated party with respect to such debt.

(d) If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

(e) Any institution-affiliated party of a insured depository institution shall be considered to be acting in a fiduciary capacity with respect to the purposes of subsection (a)(4) or (11).